BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

TOM FORESE – Chairman
BOB BURNS
DOUG LITTLE
ANDY TOBIN
BOYD W. DUNN

IN THE MATTER OF:

SHADOW BEVERAGES AND SNACKS, LLC, an Arizona Limited Liability company,

LUCIO GEORGE MARTINEZ and LISA K. MARTINEZ, husband and wife,

SAMUEL A. JONES, a married man[1]

Respondents.

DOCKET NO. S-20948A-15-0422

DECISION NO. 76155

OPINION AND ORDER

DATE OF PRE-HEARING CONFERENCE:	February 23, 2016
DATES OF HEARING:	June 6 and 7, 2016
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Mark Preny
APPEARANCES:	Mr. George Martinez and Mrs. Lisa Martinez, pro per; and Mr. Paul Kitchin, Staff Attorney, on behalf of the Securities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On December 30, 2015, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, for Restitution, for Administrative Penalties, and for Other Affirmative Action ("Notice") against Shadow Beverages and Snacks, LLC ("Shadow Beverages"), Lucio George Martinez and Lisa K. Martinez, husband and wife (the "Martinezes"), and Samuel A. Jones

[1] Respondent Samuel A. Jones waived his right to a hearing and consented to the Commission's Order in Decision No. 75552, filed May 13, 2016.

(collectively "Respondents") in which the Division alleged violations of the Arizona Securities Act ("Act") in connection with the offer and sale of securities in the form of promissory notes and/or investment contracts.

The spouse of Lucio George Martinez, Lisa K. Martinez ("Respondent Spouse"), is joined in the action pursuant to A.R.S. § 44-2031(C) solely for the purpose of determining the liability of the marital community.

The Respondents were duly served with a copy of the Notice.

On January 20, 2016, Respondent Samuel A. Jones filed a Request for Hearing pursuant to A.A.C. R14-4-306.

On February 1, 2016, by Procedural Order, a pre-hearing conference was scheduled to commence on February 23, 2016.

On February 4, 2016, Respondent Samuel A. Jones filed an Answer to the Notice.

On February 8, 2016, Respondent George Martinez filed a "Response to Docket No – S-20948A-15-0422" ("Response"). The Response made factual assertions and argued against the applicability of the statutory violations alleged by the Division.

On February 9, 2016, by Procedural Order, the pre-hearing conference was affirmed. Mr. Martinez's Response was considered a request for hearing and answer to the Notice, and he was provided notice of the upcoming pre-hearing conference.

On February 23, 2016, the pre-hearing conference was held as scheduled. The Division appeared through counsel, as did Mr. Jones. Mr. Martinez appeared on his own behalf and stated that he was in the process of obtaining counsel. The scheduling of a hearing date was discussed. Mr. Martinez was informed that because he is not an attorney, he cannot represent Respondent Spouse. The Division stated that it interpreted Mr. Martinez's Response to also include a request for hearing by Respondent Spouse.

On February 23, 2016, by Procedural Order, a hearing was scheduled to commence on June 6, 2016.

On April 19, 2016, the Securities Division filed a Proposed Consent Order in regards to Respondent Samuel A. Jones.

On May 13, 2016, the Commission issued Decision No. 75552, Order to Cease and Desist, Order for Restitution, and Order for Administrative Penalties and Consent to Same by: Samuel A. Jones.

On June 3, 2016, Respondent George Martinez filed a document titled "Critical Information and Plea to Docket No. S-20948A-15-0422." In the document, Mr. Martinez provided information and argument in support of his request that Mrs. Martinez "be dismissed from this hearing" and that he be held not responsible "for acting solely on the behalf of and for the benefit of Shadow Beverages with no personal gain for myself over the past 5 years."

On June 6, 2016, a full public hearing was commenced before a duly authorized Administrative Law Judge of the Commission at its offices in Phoenix, Arizona. The Division was represented by counsel and the Martinezes appeared pro per. At the conclusion of the hearing, the matter was taken under advisement pending the submission of a Recommended Opinion and Order.

On July 20, 2016, the Division filed its Post-Hearing Brief.

On August 5, 2016, the Division filed a Consent to Email Service.

On August 9, 2016, by Procedural Order, the Division's Consent to Email Service was granted.

On August 18, 2016, Respondents George Martinez and Lisa K. Martinez filed a Request for an Extension of Time, from August 19, 2016, until September 15, 2016, to file their Reply to the Securities Division's Post-Hearing Brief. Respondents stated that the Martinez family had been dealing with a family member's diagnosis with cancer and his resultant chemo-therapy, radiation and surgery. Respondents also stated that Mr. Martinez had been attempting to find employment which required travel time and meetings in the past 60 days.

On August 19, 2016, the Division filed a Response to the Request for Extension of Time, stating that the Division had no objection to the requested extension.

On August 22, 2016, by Procedural Order, the deadline for the filing of the Respondents' Post-Hearing Brief was extended to September 15, 2016. The deadline for the filing of the Division's Reply Brief was also extended to October 3, 2016.

On September 15, 2016, the Respondents filed a Post Hearing Brief.

On September 29, 2016, the Division filed a Reply to the Post-Hearing Brief of Lucio George

Martinez.

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DISCUSSION

I. Brief Summary

This is an enforcement action brought against Respondents Shadow Beverages and Snacks, LLC, Lucio George Martinez, and Lisa K. Martinez for alleged violations of the Arizona Securities Act. The Division alleges that, through the sale of sixteen promissory notes and one investment contract, Shadow Beverages and Mr. Martinez offered and sold unregistered securities while not registered as dealers or salesmen, in violation of A.R.S. §§ 44-1841 and 44-1842. The Division further alleges that the Respondents committed fraud, in violation of A.R.S. § 44-1991(A), by failing to disclose to investors that: 1) Shadow Beverages had defaulted on the repayment dates of prior promissory notes, 2) Mr. Martinez had failed to perform on prior personal guaranties of promissory notes, 3) Shadow Beverages had granted a $1,000,000 security interest to a bank, and 4) a $1.4 million judgment had been entered against Shadow Beverages. Additional fraud allegations have been raised by the Division for misrepresentations made to two investors. Mr. Martinez is also alleged to be a control person of Shadow Beverages. Mrs. Martinez is included in this action solely for the purpose of determining liability of the marital community. The Division requests that the Respondents be ordered to pay restitution in the amount of $1,492,500. The Division further recommends administrative penalties be ordered in the amounts of $75,000 against Shadow Beverages and $75,000 against Mr. Martinez.

The Respondents contend that Mr. Martinez believed Shadow Beverages acted lawfully based upon assertions made to him by a senior vice president of the company. The Respondents further argue that the security interest granted to the bank did not overextend collateral pledged through promissory notes to investors. The Respondents argue that the evidence does not support the Division's fraud allegations. Mr. Martinez denies the allegation of control person liability as he did not have sole-decision making authority. As Mrs. Martinez did not participate in the alleged violations, the Respondents contend that the marital community of the Martinezes should not be subject to liability based upon: 1) the statutory exclusion of transactions of guaranty from community property, and 2)

analogous tort law. The Respondents request that the Commission order Shadow Beverages to pay restitution pursuant to its bankruptcy proceedings and that Shadow Beverages cease and desist operating as a company.

II. Testimony

Catherine Leyen

Ms. Leyen testified that she has been a resident of Gilbert, Arizona, for thirteen years.[2] Ms. Leyen testified that she made two investments with Shadow Beverages.[3] The initial investment was $25,000 and the second investment was $50,000.[4] Ms. Leyen testified that she had only received $1,250 back from her investments.[5] Ms. Leyen first heard about Shadow Beverages when she worked with a company that was helping businesses expand into India.[6] Ms. Leyen testified that she helped place Shadow Beverages in contact with persons who could help them raise money, including bankers and persons in the securities industry.[7]

Ms. Leyen testified that Mr. Martinez said he needed her investment for a production run to make a product and he would repay the money immediately thereafter with a percentage increase on return.[8] Ms. Leyen testified that Mr. Martinez told her this over the phone and in his office in Arizona a few days prior to her making her investment.[9] Ms. Leyen handed Mr. Martinez her investment check in a coffee shop in Gilbert, Arizona.[10] This first investment was documented in a Loan Agreement between Shadow Beverages and Ms. Leyen with her domestic partner, Don Johnson, dated December 6, 2013, signed by Ms. Leyen and Mr. Martinez.[11] Ms. Leyen testified that at the time of the investment, neither she nor Mr. Johnson had a net worth of $1 million or an annual income greater than $200,000, and neither Mr. Martinez nor anyone else from Shadow Beverages had inquired as to her income or net worth prior to her investing.[12] Ms. Leyen testified that she received a Shadow Beverages

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[2] Tr. at 33-34.
[3] Tr. at 34.
[4] Tr. at 34, 42, 48.
[5] Tr. at 34, 51-52.
[6] Tr. at 35, 54-55.
[7] Tr. at 36.
[8] Tr. at 37-38.
[9] Tr. at 38.
[10] Tr. at 38, 45-46; Exh. S-40.
[11] Tr. at 41-43; Exh. S-39.
[12] Tr. at 43-44, 57-58.

executive summary, dated December 2013, prior to investing.[13] The December 2013 executive summary included information about Shadow Beverages' GNC beverages brand and stated that Shadow Beverages had a five-year licensing agreement with a five-year renewal based on performance.[14] Ms. Leyen testified that prior to investing, she was not told Shadow Beverages was involved in a lawsuit with GNC.[15] Ms. Leyen testified that this information would have been significant to her decision to invest.[16] Ms. Leyen testified that she and Mr. Johnson had little investment experience prior to investing in Shadow Beverages.[17]

Ms. Leyen testified that the loan was originally due to mature in March 2014, then extended by agreement to May 2014.[18] By written agreement, dated May 1, 2014, the loan was again extended to mature on August 31, 2014, with an additional $6,000 in interest to be paid by Shadow Beverages.[19] Ms. Leyen testified that she was told by Mr. Martinez that Shadow Beverages needed capital for production and to build out new brands.[20]

Ms. Leyen made her second investment at Shadow Beverages' office in Arizona.[21] Before making her second investment, Ms. Leyen received a Shadow Beverages executive summary, dated March 2014, from Mr. Martinez via email.[22] The March 2014 executive summary included information about Shadow Beverages' GNC beverages brand and stated that Shadow Beverages was currently in discussions with GNC to continue their agreement.[23] Ms. Leyen testified that about a week prior to making her second investment, Mr. Martinez spoke with her at his office and said that Shadow Beverages was growing and had new brands.[24] Before making her second investment, Ms. Leyen was not informed that GNC had a $1.4 million judgment against Shadow Beverages.[25] Ms. Leyen testified

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[13] Tr. at 39-40; Exh. S-92.
[14] Exh. S-92 at 3.
[15] Tr. at 40.
[16] *Id.*
[17] Tr. at 44.
[18] Tr. at 46; Exh. S-91.
[19] Tr. at 46-47; Exh. S-91.
[20] Tr. at 47.
[21] Tr. at 38-39.
[22] Tr. at 44-45; Exh. S-93.
[23] Exh. S-93 at 3.
[24] Tr. at 49-50.
[25] Tr. at 45.

that this information would have been significant in making her decision to invest.[26] The second investment was recorded in a promissory note dated May 9, 2014.[27]

Ms. Leyen testified that before making either of her two investments, she was not told whether Shadow Beverages had defaulted on any previous notes.[28] Ms. Leyen testified that this information would have been significant in making her decision to invest as it would have indicated bad management of the company.[29] Ms. Leyen testified that the loss of funds has caused her financial hardship.[30]

Reed Hatkoff

Mr. Hatkoff testified that he has lived in Phoenix, Arizona, since 1995.[31] Mr. Hatkoff testified that Rick Peterson, an officer of Shadow Beverages, spoke with him at his home office about making a loan to Shadow Beverages in March 2014.[32] Mr. Hatkoff testified that Mr. Peterson said the money would be used to purchase inventory.[33] Mr. Hatkoff also spoke briefly with Mr. Martinez over the phone while Mr. Peterson was at his home office.[34] Mr. Hatkoff testified that Mr. Peterson provided him a prospectus about Shadow Beverages.[35] This document, dated March 2014, included information about Shadow Beverages' GNC beverage brand and stated that Shadow Beverages was currently in discussions with GNC to continue their agreement.[36] Mr. Hatkoff testified that Mr. Peterson had brought him a sample case of the GNC beverage.[37] Mr. Hatkoff testified that he was not informed whether Shadow Beverages was in litigation with GNC or whether GNC had a judgment against Shadow Beverages.[38] Mr. Hatkoff testified that had he been told GNC obtained a judgment against Shadow Beverages, he would not have made the loan.[39]

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[26] *Id.*
[27] Tr. at 47-48, 50; Exh. S-41.
[28] Tr. at 52.
[29] *Id.*
[30] Tr. at 52-53.
[31] Tr. at 59-60.
[32] Tr. at 60-61.
[33] Tr. at 61.
[34] Tr. at 61-62.
[35] Tr. at 62-63; Exh. S-61.
[36] Exh. S-61 at ACC000050.
[37] Tr. at 63.
[38] *Id.*
[39] Tr. at 63-64.

Mr. Hatkoff testified that he made the loan via a wire transfer he initiated from Arizona.[40] Mr. Hatkoff testified that at the time he was an accredited investor, though he was not asked by anyone with Shadow Beverages whether he was an accredited investor prior to making his investment.[41] Mr. Hatkoff had no role with Shadow Beverages other than as a lender and a creditor.[42] Mr. Hatkoff testified that he made a loan of $100,000 and he was to receive an interest payment of $15,000.[43] The loan was reflected in a promissory note, effective date March 21, 2014.[44] As a requirement of the loan, Mr. Hatkoff also received a security interest in collateral of Shadow Beverages' accounts receivable and inventory.[45] Mr. Hatkoff testified that before making his loan, he was not informed another party had a $1,000,000 security interest in Shadow Beverages' accounts receivable and product inventory.[46] Mr. Hatkoff testified that he understood himself to be the sole designee of collateral and had he been told Shadow Beverages already had a $1,000,000 security interest in existence, he would not have lent the money.[47]

Mr. Hatkoff testified that he requested and received a Personal Financial Statement ("PFS") of Mr. Martinez prior to making his investment.[48] The PFS, signed by Mr. Martinez and dated January 27, 2014, stated that he was not a guarantor of any person or company and that no judgment had been entered against him.[49] Mr. Hatkoff testified this information was significant to his decision to lend to Shadow Beverages as it indicated Mr. Martinez's assets were clear to pledge in the deal and spoke to his credit worthiness.[50] Mr. Hatkoff testified that he never received any loan payments from Shadow Beverages, though he did receive $45,000 from Mr. Martinez to forestall a foreclosure sale of his interest in Shadow Beverages.[51] Mr. Hatkoff testified that before making his loan he was not told whether Shadow Beverages had defaulted on previous promissory notes.[52] Mr. Hatkoff testified that

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[40] Tr. at 63.
[41] Tr. at 65, 76.
[42] Tr. at 65.
[43] Tr. at 66; Exh. S-49.
[44] *Id.*
[45] Tr. at 67-68; Exh. S-51.
[46] Tr. at 68.
[47] Tr. at 68-69.
[48] Tr. at 70; Exh. S-52.
[49] Tr. at 71-72; Exh. S-52.
[50] Tr. at 71-72.
[51] Tr. at 72-73.
[52] Tr. at 73.

this information would have been significant to his decision to make the loan as a prior default would have indicated a credit risk.[53]

Michael Brokaw

Mr. Brokaw testified that he is a senior special investigator for the Securities Division and served as the lead investigator in the Shadow Beverages case.[54] Mr. Brokaw testified that, in the Shadow Beverages case, he interviewed investors, sat in on an examination under oath of Mr. Martinez, and subpoenaed bank and other records.[55] Mr. Brokaw testified that he spoke twice with Stacey Gervasi, a Colorado resident, who said she and her husband invested $50,000 in Shadow Beverages, combined with another $50,000 from their friends, the Van Kilsdonks, for a total investment of $100,000 under an LLC named Eight Paws.[56] Mr. Brokaw testified that Mrs. Gervasi heard about Shadow Beverages from her father who had previously invested in the company.[57] Mr. Brokaw testified that Mrs. Gervasi said she had no role other than being an investor for Shadow Beverages though Mrs. Van Kilsdonk may have worked for them for a short time.[58] Mr. Brokaw testified that Mrs. Gervasi said she and her husband were not accredited investors when they invested in Shadow Beverages, and no one at Shadow Beverages asked if she was an accredited investor prior to her investing.[59] Mr. Brokaw testified that prior to investing, Mrs. Gervasi was not informed whether Shadow Beverages had defaulted on any previous notes.[60] Mr. Brokaw testified that Mrs. Gervasi received only a $5,000 return on her investment and that the loss of her investment has been a hardship on their buying power for several years.[61]

Mr. Brokaw testified that he telephonically interviewed Kurt Moore, a Texas resident, who was introduced to Shadow Beverages by Michael Crane, an investor.[62] Mr. Brokaw testified that Mr. Moore invested $100,000 in Shadow Beverages in 2014, by wire transfer, and received a promissory note.[63]

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[53] Tr. at 73-74.
[54] Tr. at 81-82.
[55] Tr. at 82.
[56] Tr. at 82-83, 89.
[57] Tr. at 83-84.
[58] Tr. at 84-85, 89-90.
[59] Tr. at 85, 91.
[60] Tr. at 85.
[61] Tr. at 85-86.
[62] Tr. at 86, 90.
[63] Tr. at 86-87.

Mr. Brokaw testified that Mr. Moore was an accredited investor when he invested in Shadow Beverages, though no one at Shadow Beverages asked if he was an accredited investor prior to his investing.[64] Mr. Brokaw testified that Mr. Moore invested in Shadow Beverages because it offered a good return on his money.[65] Mr. Brokaw testified that before Mr. Moore invested, he was not informed whether Shadow Beverages had defaulted on any previous notes, whether Mr. Martinez had failed to perform on any prior personal guarantees, or whether GNC had a $1.4 million judgment against Shadow Beverages.[66] Mr. Brokaw testified that he did not think that Mr. Moore had received any principal or interest payments from Shadow Beverages.[67]

Avi Beliak

Mr. Beliak testified that he is a forensic accountant employed by the Securities Division who assisted in reviewing financial information in the Shadow Beverages case and created a summary listing of investors, from July 1, 2009 through July 18, 2014, based upon approximately 2,500 pages of information received through subpoena of banks used by Mr. Martinez and Shadow Beverages.[68] Mr. Beliak testified that according to the documents he summarized, $2,005,000 was raised from investors with approximately $546,000 repaid, leaving approximately $1,458,000 principal owed.[69]

Lucio George Martinez

Mr. Martinez testified that Mrs. Van Kilsdonk worked as a paid employee of Shadow Beverages for one year, providing administrative support for the beverage products sales team.[70] Mr. Martinez further testified that Mr. DeMello and Ms. Leyen felt they were close to bringing in other capital investors for Shadow Beverages and their notes would be paid off.[71] Mr. Martinez testified that he received the guidance of legal counsel in creating the loan documentation for processing capital.[72]

Mr. Martinez testified that the documents provided to investors regarding Shadow Beverages' relationship with GNC were not misleading and he noted the change in language from the December

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[64] Tr. at 87, 92.
[65] Tr. at 87.
[66] Tr. at 88.
[67] *Id.*
[68] Tr. at 101-104; Exh. S-74.
[69] Tr. at 105.
[70] Tr. at 112-113, 131-132; Exh. M-01.
[71] Tr. at 114-116; Exh. M-02.
[72] Tr. at 117-118; Exh. M-03.

2013 document, which stated "Five-year licensing agreement with five-year renewal based on performance," and the March 2014 document which stated "Currently under discussion with GNC to continue agreement."[73] Mr. Martinez testified that Shadow Beverages still had a licensing agreement with GNC in December 2013, and while a contract closure was agreed upon later that month, discussions with GNC continued regarding other options.[74] At the time of the hearing, Shadow Beverages still owed GNC $1.4 million for the judgment against the company.[75]

Mr. Martinez testified that Rick Peterson, as an officer of Shadow Beverages, raised capital for the company.[76] Mr. Martinez testified that Mr. Peterson obtained advice from an attorney friend who said they were acting within SEC guidelines, though Mr. Martinez admitted never speaking to the attorney himself.[77] Mr. Martinez testified that Mr. Peterson had also invested $100,000 of his own money as a loan to Shadow Beverages.[78] Mr. Martinez testified that he was not personally involved in raising capital.[79]

Mr. Marinez testified that Shadow Beverages had maintained collateral in the company and cited its sale of the "No Fear" brand license for $12.2 million in March 2015.[80] Mr. Martinez further testified that Shadow Beverages maintained intangible value in its customer lists and operating relationships.[81]

Mr. Martinez testified that Shadow Beverages was currently in a Chapter 7 bankruptcy proceeding in Arizona bankruptcy court.[82]

Mr. Martinez testified that on February 25, 2014, Darrell DeMello invested $135,000 in cash in Shadow Beverages for a promissory note, which promised a fixed amount of interest of $22,500.[83] Mr. Martinez testified that a $1,200 payment was made to Mr. DeMello and he did not recall Mr.

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[73] Tr. at 118-119, 121; Exhs. S-92, S-93.
[74] Tr. at 120-121; Exh. M-04.
[75] Tr. at 132.
[76] Tr. at 122, 124-125; Exh. M-05.
[77] Tr. at 123, 132; Exh. M-05.
[78] Tr. at 125.
[79] Tr. at 127.
[80] Tr. at 127-128; Exh. M-06.
[81] Tr. at 128-129.
[82] Tr. at 131.
[83] Tr. at 134-135.

DeMello receiving any other payments of interest or principal.[84] Mr. Martinez testified that Mr. DeMello unsuccessfully attempted to raise capital for Shadow Beverages in India before investing himself.[85] Mr. Martinez testified that he had told Mr. DeMello about Shadow Beverages' business plan and the company's need for capital.[86] Mr. Martinez testified that Mr. DeMello was told that his money would be used for production and freight.[87] Mr. Martinez testified that Mr. DeMello was initially introduced to Shadow Beverages by Rick Peterson, approximately a year and a half before Mr. DeMello made his investment.[88] Mr. Martinez testified that Mr. DeMello was aware Shadow Beverages had not paid some of its previous notes on time and the company was not current in paying debt.[89] Mr. Martinez testified that prior to investing, Mr. DeMello would have received an executive summary containing the same information about GNC as the one dated March 14, 2014.[90] Mr. Martinez testified that he told Mr. DeMello and Mr. Peterson of the $1.4 million GNC judgment against Shadow Beverages, but he did not instruct either of them to inform potential investors about the judgment.[91] Mr. Martinez testified that no one at Shadow Beverages asked Mr. DeMello what his net worth or income was before he invested and, while Mr. Martinez knew that Mr. DeMello was at one point worth three to five million dollars, Mr. DeMello may have had a net worth under one million dollars at the time he invested.[92]

Mr. Martinez testified that he has been the president of Shadow Beverages since sometime in 2010, and in that position he handled the company's day-to-day business, managed the sales and operations teams, oversaw the director of administration, and served as the boss of the Senior Vice President of Capital Acquisition, Rick Peterson, though he did not manage Mr. Peterson's daily schedule.[93] Mr. Martinez testified that Mr. Peterson raised capital for Shadow Beverages with promissory notes and he found investors David Kelly, Jason and Robbyn Salganick, Reed Hatkoff,

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[84] Tr. at 136-137.
[85] Tr. at 137.
[86] Tr. at 140-141.
[87] Tr. at 141.
[88] Tr. at 141-142.
[89] Tr. at 142-143.
[90] Tr. at 143-144; Exh. S-93 at 3.
[91] Tr. at 145-147.
[92] Tr. at 148-149.
[93] Tr. at 149-150, 178.

Michael Crane, and Kurt Moore.[94]

Mr. Martinez testified that Mr. Kelly was named as an individual interested in investing during conversations Shadow Beverages had with the company Go Daddy.[95] Mr. Martinez testified that David Kelly came to Shadow Beverages' offices to consummate a $500,000 investment in Shadow Beverages by him and Canis Major Development.[96] Mr. Martinez testified that he gave Mr. Kelly a personal guaranty on the investment, but he did not tell Mr. Kelly that he had not performed on prior personal guaranties.[97] Mr. Martinez testified that he has been a guarantor of the investment since March 7, 2013.[98] Mr. Martinez testified he did not recall anyone telling Mr. Kelly about any preexisting security interests in the company's assets or about defaults on prior Shadow Beverages notes.[99]

Mr. Martinez testified that he prepared and signed a personal financial statement in December 2013, which was given to one investor in Shadow Beverages.[100] Under the category of "Contingent Liabilities," the personal financial statement asks "Are you a Guarantor, Co-maker or Endorser for any person or company?" to which Mr. Martinez checked "No."[101] Mr. Martinez testified that this answer must have been a mistake as he was a guarantor for Mr. Kelly's note for Canis Major Development at the time.[102] Also under the category of "Contingent Liabilities," the personal financial statement asks "Have any judgements [sic] ever been entered against you?" to which Mr. Martinez checked "No."[103] Mr. Martinez testified that in 2011 Brent Tunnell sued and won a judgment against Shadow Beverages and Mr. Marinez after Mr. Tunnell was not repaid by the maturity dates of the Shadow Beverage notes in which he invested.[104] Mr. Martinez testified that he checked "No" to the question regarding judgments because Mr. Tunnell agreed to a covenant not to execute the judgment and Mr. Martinez understood from speaking with counsel that "it would be like the judgment never happened."[105] Mr.

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[94] Tr. at 150-151, 170.
[95] Tr. at 170-171.
[96] Tr. at 151-154; Exh. S-28.
[97] Tr. at 152-154, 171-172; Exh. S-32.
[98] Tr. at 154-155; Exhs. S-28, S-32.
[99] Tr. at 154.
[100] Tr. at 155-156; Exh. S-52.
[101] Tr. at 156; Exh. S-52 at ACC000403.
[102] Tr. at 156.
[103] Tr. at 158; Exh. S-52 at ACC000403.
[104] Tr. at 157-158; Exh. S-15.
[105] Tr. at 158-160; Exh. S-16.

Martinez testified that a copy of the personal financial statement was given to Mr. Hatkoff but he was not informed about the judgment won by Mr. Tunnell or why Mr. Martinez answered "No" to the question regarding judgments.[106]

Mr. Martinez testified that investor George Karas was a personal friend who was informed of the investment opportunity with Shadow Beverages by Mr. Martinez and Richard Scherer, an equity holder and founding partner.[107] At the time of Mr. Karas' investment, in June 2009, Mr. Martinez was the Chief Customer Officer for Shadow Beverages.[108]

Mr. Martinez testified that investor Brent Tunnell was introduced to Shadow Beverages by the company's operations manager, Joe Dunnigan.[109] Mr. Martinez testified that when Mr. Tunnell made his investments, on February 17 and March 17, 2010, Mr. Martinez had not yet become president of Shadow Beverages.[110] Mr. Martinez later testified that he had signed a promissory note dated January 29, 2010, as the president of Shadow Beverages, and he admitted having authority to do so.[111] Mr. Martinez testified he had little to do with the transaction involving Mr. Tunnell other than to present the Shadow Beverages' business model.[112] Mr. Martinez testified that the responsibilities of the transaction fell to Mr. Dunnigan, Ryan Weissmueller (the chief financial officer), and outside legal counsel.[113]

Mr. Martinez testified that he was president and Sam Jones was the CEO when Scott Jarus and the Jarus Family Trust invested on September 1, 2010.[114] Mr. Martinez testified that Mr. Jones was the primary contact with Mr. Jarus and that Shadow Beverages licensed a trademark from a company over which Mr. Jarus was the CEO.[115] According to Mr. Martinez, Mr. Jarus knew that Shadow Beverages was growing and needed money for production so he made an investment.[116] Mr. Martinez testified that he did not know if Mr. Jarus was specifically asked about his income or net worth by

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[106] Tr. at 160.
[107] Tr. at 162-163.
[108] Tr. at 163.
[109] Tr. at 163-164.
[110] Tr. at 164-165.
[111] Tr. at 179-180; Exh. S-70.
[112] Tr. at 165.
[113] *Id.*
[114] Tr. at 166.
[115] *Id.*
[116] Tr. at 166-167.

anyone at Shadow Beverages, however, he understood Mr. Jarus to be "very wealthy," earning a big salary in his CEO position.[117]

Mr. Martinez testified that he discussed the investment opportunity in Shadow Beverages with investor Ronald Barrett, a personal friend.[118] Mr. Martinez testified that he knew Mr. Barrett owned contracting companies and had a net worth of over $5 million.[119]

Mr. Martinez testified that Mrs. Gervasi learned about the investment at a barbecue she hosted during a conversation with him, Mrs. Gervasi's father, and Michelle and Gary Van Kilsdonk.[120] Mr. Martinez testified that Mrs. Gervasi made her investment within a couple months of this discussion.[121] Mr. Martinez testified that he did not know if anyone with Shadow Beverages inquired as to Mrs. Gervasi's income or net worth, but he knew Mrs. Gervasi's husband was a police detective in Mesa and she never worked.[122]

Mr. Martinez testified that Rick Andersen is his cousin from Omaha, Nebraska, and they discussed finances when Mr. Andersen had been out to visit.[123] Mr. Martinez testified that Mr. Andersen had been investing in gold, having bought "a couple million dollars" of gold bars.[124] After Mr. Martinez told Mr. Andersen about Shadow Beverages' business, Mr. Andersen expressed an interest in investing, and, after he flew home, Mr. Andersen called Mr. Martinez to say he would invest $250,000.[125] Mr. Andersen made a second investment of $250,000 a year later, through Legacy Insurance Services, Inc.[126]

Mr. Martinez testified that N. James Stephensen was a professional off-road truck driver who Shadow Beverages sponsored for three years in return for branding on his truck.[127] Mr. Martinez testified that the branding agreement was cancelled when Mr. Stephensen was injured and quit

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[117] Tr. at 167-168.
[118] Tr. at 168.
[119] *Id.*
[120] Tr. at 169.
[121] *Id.*
[122] Tr. at 169-170.
[123] Tr. at 172.
[124] *Id.*
[125] Tr. at 173; Exhs. S-34, S-35, S-36, S-74.
[126] Tr. at 173-174; Exhs. S-37, S-38, S-74.
[127] Tr. at 174.

racing.[128] Mr. Martinez testified that when Shadow Beverages sought money for production, they spoke with Mr. Stephensen, who said he could invest $30,000.[129] Mr. Martinez testified that he knew Mr. Stephensen and his mother had a large ranch in Utah worth a few million dollars and they owned a large pest control business in Las Vegas.[130]

Mr. Martinez testified that he never met Jason Salganick and only met Robbin Salganick once when she came to the Shadow Beverages office to pick up some cases of product for a school event.[131] Mr. Martinez testified that Mr. Peterson was a neighbor of Mr. and Mrs. Salganick and he learned through Mr. Peterson that the Salganicks were "highly paid professionals," a doctor and an attorney.[132] Mr. Martinez testified that he did not know if anyone with Shadow Beverages had inquired as to their net worth or combined income prior to their investment with the company.[133]

Mr. Martinez testified that he had never met or spoken with investors Michael Crane and Debra Martin.[134] Mr. Martinez testified that he did not know if anyone with Shadow Beverages had inquired as to the income or net worth of Mr. Crane and Ms. Martin prior to their investing in the company.[135] Mr. Martinez testified that Mr. Peterson knew both Mr. Crane and Kurt Moore after Mr. Peterson had raised capital for a vodka company they started.[136] Mr. Martinez testified that he spoke once to Mr. Moore on a conference call where Mr. Martinez gave him a brief description of his background.[137] Mr. Martinez testified that he did not know if anyone with Shadow Beverages had inquired as to the income or net worth of Mr. Moore prior to his investing in the company.[138]

III. Relevant Transactions

George Karas (Investment 1)

Investor George Karas invested $50,000 in a Shadow Beverages promissory note on June 1,

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[128] Tr. at 174-175.
[129] *Id.*
[130] Tr. at 175.
[131] *Id.*
[132] Tr. at 175-176.
[133] Tr. at 176.
[134] Tr. at 176-177.
[135] Tr. at 176.
[136] Tr. at 177.
[137] *Id.*
[138] *Id.*

2009.[139] Mr. Karas worked as a salesperson.[140] The note was executed in Phoenix, Arizona, where it was signed by Mr. Karas and by Mr. Martinez as Managing Partner for Shadow Beverages.[141] Mr. Martinez knew Mr. Karas through prior consulting work and he considered Mr. Karas a personal friend.[142] Mr. Martinez and another partner in Shadow Beverages spoke with Mr. Karas about the investment opportunity.[143] The note was to pay 15% annual interest and was due on December 31, 2009.[144] Shadow Beverages defaulted on the note and, on March 19, 2012, an amendment was made revising the note's maturity date to June 30, 2012.[145] The note was repaid on August 15, 2012.[146]

Brent Tunnell (Investments 2 and 3)

Arizona investor Brent Tunnell invested $50,000 in a Shadow Beverages promissory note on February 17, 2010.[147] Mr. Tunnell had owned a sports ticketing company and had recently sold the business prior to investing in Shadow Beverages.[148] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Sam Jones as Chief Executive Officer and by the Martinezes as guarantors of the note.[149] Mr. Tunnell primarily communicated with Joe Dunnigan, the operations manager for Shadow Beverages, though Mr. Martinez presented the company's business model.[150] Before investing, Mr. Tunnell was not informed that Shadow Beverages had previously defaulted on the note to Mr. Karas.[151] Mr. Tunnell's note was to pay 25% annual interest and was due on August 17, 2010.[152] Shadow Beverages defaulted on the note at that time and Mr. Martinez made no repayment on the guaranty of the note.[153]

On March 17, 2010, Mr. Tunnell made a second investment of $200,000 in a Shadow Beverages

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[139] Exh. S-4.
[140] Tr. at 162.
[141] Exhs. S-4, S-88 at 160.
[142] Tr. at 162.
[143] Tr. at 163.
[144] Exh. S-4.
[145] Exh. S-5.
[146] Exh. S-6.
[147] Exhs. S-7, S-8.
[148] Tr. at 164.
[149] Exh. S-7. The Martinezes also signed another document as guarantors of the February 17, 2010 note. Exh. S-9.
[150] Tr. at 163-165; Exh. S-88 at 171.
[151] Exh. S-88 at 173-174.
[152] Exh. S-7.
[153] Exhs. S-13 at ACC000325, S-16, S-88 at 178.

promissory note.[154] The note was executed in Phoenix, Arizona, where it was signed by George Martinez with four other managers for Shadow Beverages and by the Martinezes as guarantors of the note.[155] In a loan agreement executed in connection with the investment on March 17, 2010, Shadow Beverages stated that it was not in default on any indebtedness for borrowed money.[156] The note was to pay 25% annual interest and was due on September 17, 2010.[157] Shadow Beverages defaulted on the note at that time.[158] On May 17, 2011, a judgment in favor of Mr. Tunnell was entered against Shadow Beverages, Mr. Martinez and other defendants.[159] The two notes of Mr. Tunnell were fully paid by Shadow Beverages in August 2011.[160]

Scott Jarus (Investment 4)

Investor Scott Jarus invested $75,000 in a Shadow Beverages promissory note on September 1, 2010.[161] Mr. Jarus was the CEO of a company that primarily produced gloves for construction workers.[162] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Samuel Jones, as CEO, and Mr. Martinez as President.[163] Mr. Jarus met with Mr. Martinez and Mr. Jones in Arizona about making an investment.[164] Prior to investing, Mr. Jarus was not informed that Mr. Martinez failed to perform on a personal guaranty of a Shadow Beverages note.[165] The note was to pay 15% annual interest and was due on December 31, 2010, at which time Shadow Beverages defaulted on the note.[166] Mr. Martinez signed a guaranty on the note, effective September 7, 2010, but made no payments.[167] Shadow Beverages fully paid the note in August 2011.[168]

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[154] Exhs. S-11, S-12, S-13 at ACC000324.
[155] Exh. S-11.
[156] Exhs. S-14 at SHADOW007310, S-88 at 181. The loan agreement was signed by Mr. Martinez and four other managers of Shadow. Exhs. S-14 at SHADOW007316, S-88 at 181.
[157] Exh. S-11.
[158] Tr. at 157; Exhs. S-11, S-13 at ACC000326, S-16.
[159] Tr. at 157; Exh. S-15.
[160] Exhs. S-16, S-17, S-88 at 185.
[161] Exhs. S-18, S-19.
[162] Tr. at 166.
[163] Exhs. S-18, S-88 at 189.
[164] Exh. S-88 at 188.
[165] *Id.* at 191.
[166] Exhs. S-18, S-88 at 192.
[167] Exhs. S-20, S-88 at 191-192.
[168] Exh. S-21.

Ronald Barrett (Investment 5)

Investor Ronald Barrett invested $125,000 in a Shadow Beverages promissory note on January 3, 2011.[169] Mr. Barrett was an owner of contracting companies.[170] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[171] Mr. Martinez discussed the investment in Shadow Beverages with Mr. Barrett, who is a family friend.[172] Mr. Barrett was not told of any note defaults by Shadow Beverages prior to investing.[173] The note was to pay 10% annual interest and was due on March 1, 2011, at which time Shadow Beverages defaulted on the note.[174] Shadow Beverages fully paid the note later in 2011.[175]

Gervasi / Van Kilsdonk (Investment 6)

On January 14, 2011, Stacey Gervasi signed a promissory note for a $100,000 investment in Shadow Beverages.[176] The promissory note was executed in Phoenix, Arizona, and signed for Shadow Beverages by Samuel Jones as COO and George Martinez as President.[177] The promissory note reflected two combined investments of $50,000 each from Gary and Michelle Van Kilsdonk and from Robert and Stacey Gervasi.[178] Mr. Gervasi was a police officer while Mrs. Gervasi did not work.[179] Approximately two months prior to the execution of the combined investment, Mr. Martinez discussed the investment opportunity with the two couples and Mrs. Gervsi's father, George Karas, at a barbecue at the Gervasi residence.[180] Subsequent to the investment, Mrs. Van Kilsdonk was employed by Shadow Beverages for approximately one year doing administrative duties.[181] Prior to investing, Mrs. Gervasi was not informed whether Shadow Beverages had defaulted on any previous notes.[182] Mr. and Mrs. Gervasi were not accredited investors at the time they invested in Shadow Beverages.[183] The note

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[169] Exhs. S-22, S-23.
[170] Tr. at 168.
[171] Exh. S-22.
[172] Tr. at 168; Exh. S-88 at 198.
[173] Exh. S-88 at 199.
[174] Exhs. S-22, S-88 at 197-198.
[175] Exh. S-88 at 197-198.
[176] Exh. S-24.
[177] Exhs. S-24; S-88 at 201.
[178] Tr. at 83-84, 89; Exhs. S-88 at 200, S-90.
[179] Tr. at 170.
[180] Tr. at 169; Exh. S-88 at 200.
[181] Tr. at 84, 89-90, 112, 131; Exh. M-1.
[182] Tr. at 85; Exh. S-88 at 201.
[183] Tr. at 85.

was to pay 10% annual interest and was due on December 31, 2011.[184] As of the hearing, Shadow Beverages had made payments totaling $5,000 on the note.[185] Subsequently, the remaining $95,000 of principal due on the note has been repaid by Respondent Samuel A. Jones pursuant to the terms of the Commission's Order in Decision No. 75552.[186]

Factoring Agreement

On October 15, 2012, Shadow Beverages entered into a $1,000,000 Factoring Agreement with a bank, signed by Mr. Martinez as president, pursuant to which the bank received a security interest in Shadow Beverages' collateral, including present and future accounts receivable and the proceeds of inventory.[187] The bank recorded its security interest with the Arizona Secretary of State.[188] The bank held this security interest until it executed a Mutual Release on October 29, 2014, signed for Shadow Beverages by Mr. Martinez as President.[189]

David Kelly and Canis Major Development (Investment 7)

Investor David Kelly, through Canis Major Development, invested $500,000 in a Shadow Beverages promissory note on March 7, 2013.[190] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[191] Mr. Kelly was brought in as an investor by Mr. Peterson and he met with Mr. Martinez, Mr. Peterson, and Mr. Jones at Shadow Beverages' offices when he made his investment.[192] Also on March 7, 2013, Mr. Kelly, through Canis Major Development, received a Limited Security Agreement, signed by Mr. Martinez as President for Shadow Beverages, providing a limited security interest in Shadow Beverages' product inventory and accounts receivable as collateral on his $500,000 loan.[193] As an inducement to the note, Mr. Kelly also received a personal guaranty on his $500,000 investment signed by Mr. Martinez and Mr. Jones.[194] Before investing, Mr. Kelly was not informed that Mr. Martinez had failed to perform on prior personal

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[184] Exh. S-24.
[185] Tr. at 85; Exh. S-74.
[186] Decision No. 75552, Division's Post-Hearing Brief at 12.
[187] Exh. S-25, S-88 at 222-223.
[188] Exh. S-26, Exh. S-88 at 220-222.
[189] Exh. S-27, S-89 at 299-300.
[190] Tr. at 151; Exhs. S-28, S-29, S-30, S-88 at 223.
[191] Exh. S-28.
[192] Tr. at 151-152, 170-172; Exh. S-88 at 223-224.
[193] Exhs. S-31, S-88 at 226.
[194] Exhs. S-32, S-88 at 226-227.

guaranties made on Shadow Beverages' notes.[195] Mr. Kelly was also not informed of any existing security interests in Shadow Beverages' product inventory and accounts receivable.[196] The note was to pay $25,000 interest every 30 days and was due on May 6, 2013.[197] Shadow Beverages defaulted on the note by failing to make the first interest payment due on April 5, 2013.[198] As of the date of the hearing, no payments had been made to Mr. Kelly on this note.[199]

Rick Andersen – First Investment (Investment 8)

Investor Rick Andersen invested $250,000 in a Shadow Beverages promissory note on April 5, 2013.[200] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[201] Mr. Martinez discussed the investment in Shadow Beverages with Mr. Andersen, his cousin, who had been investing in gold.[202] Also on April 5, 2013, Mr. Andersen received a Limited Security Agreement, signed by Mr. Martinez as President for Shadow Beverages, providing a limited security interest in Shadow Beverages' product inventory and accounts receivable as collateral on his $250,000 loan.[203] Before investing, Mr. Andersen was not informed that Shadow Beverages had defaulted on previous notes or that Shadow Beverages' product inventory and accounts receivable were subject to existing security interests.[204] The note was to pay 12% annual interest and was due on April 5, 2014, at which time Shadow Beverages defaulted on the note.[205] As of the date of the hearing, no payments had been made to Mr. Andersen on this note.[206]

Catherine Leyen and Don Johnson – First Investment (Investment 9)

Arizona investors Catherine Leyen and Don Johnson invested $25,000 in a Loan Agreement with Shadow Beverages on December 6, 2013.[207] Before investing, Ms. Leyen and Mr. Johnson were

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[195] Tr. at 153; Exh. S-88 at 226.
[196] Tr. at 153-154; Exh. S-88 at 226.
[197] Exh. S-28.
[198] Exhs. S-28, S-88 at 224.
[199] Exhs. S-74, S-88 at 227.
[200] Exhs. S-34, S-35.
[201] Exhs. S-34, S-88 at 232-233.
[202] Tr. at 172-173; Exh. S-88 at 233.
[203] Exhs. S-36, S-88 at 234.
[204] Exh. S-88 at 234.
[205] Exhs. S-34, S-88 at 233.
[206] Exh. S-74.
[207] Tr. at 41-42; Exhs. S-39, S-40.

not informed that Shadow Beverages had defaulted on previous notes.[208] The Loan Agreement was signed by Ms. Leyen and for Shadow Beverages by Mr. Martinez as President/COO.[209] Pursuant to the terms of the Loan Agreement, the $25,000 was to be used for the production of 40,000 cases of canned energy drinks.[210] Ms. Leyen considered the Loan Agreement to be an investment which she and Mr. Johnson made based upon the interest offered after a discussion with Mr. Martinez, who said Shadow Beverages needed the money for a production run, after which they would be immediately repaid.[211] Ms. Leyen performed some unpaid work for Shadow Beverages, namely providing advice on social media building and providing introductions to persons who could assist the company financially.[212] Ms. Leyen would have received finder's fees had she successfully brought in capital to Shadow Beverages.[213] Neither Ms. Leyen nor Mr. Johnson ever had management roles with Shadow Beverages.[214] At the time of their investment, Ms. Leyen and Mr. Johnson had minimal investment experience and neither had a net worth of more than $1,000,000, or an annual income over $200,000.[215]

Ms. Leyen and Mr. Johnson were to receive $5,000 as consideration on the loan, with payments of the principal and interest to begin two weeks after Shadow Beverages' initial receipt of proceeds from the sale of the cases.[216] Shadow Beverages defaulted on the loan once payments were due, on or about March 1, 2014.[217] As of the date of the hearing, Shadow Beverages had paid only $1,250 toward the Loan Agreement.[218]

General Nutrition Corporation

On January 13, 2014, General Nutrition Corporation ("GNC") was awarded a $1.4 million default judgment ("GNC Judgment") against Shadow Beverages.[219] As of the date of the hearing, no payments had been made on this judgment.[220]

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[208] Tr. at 52; Exh. S-88 at 250.
[209] Exh. S-39.
[210] *Id.*
[211] Tr. at 34, 37-38.
[212] Tr. at 36-37, 114-115.
[213] Tr. at 116.
[214] Exh. S-88 at 248.
[215] Tr. at 43-44.
[216] Exh. S-39.
[217] Exh. S-88 at 248-249; Exh. S-91.
[218] Tr. at 51-52; Exh. S-74.
[219] Exhs. S-43, S-89 at 265.
[220] Tr. at 132; Exh. S-89 at 266.

James Stephensen (Investment 10)

Investor James Stephensen invested $30,000 in a Shadow Beverages promissory note on January 13, 2014.[221] Mr. Stephensen raced as a professional off-road truck driver.[222] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[223] Mr. Martinez spoke with Mr. Stephensen about making an investment.[224] Before investing, Mr. Stephensen was not informed that Shadow Beverages had defaulted on previous notes.[225] The note was to pay $2,500 in interest and was due on April 13, 2014, at which time Shadow Beverages defaulted on the note.[226] As of the date of the hearing, no payments had been made to Mr. Stephensen on this note.[227]

Jason and Robbyn Salganick (Investment 11)

Arizona investors Jason Salganick and his wife, Robbyn Salganick, invested $50,000 in a Shadow Beverages promissory note on January 15, 2014.[228] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[229] Mr. Martinez gave a personal guaranty on the note.[230] Mr. Peterson talked to Mr. and Mrs. Salganick about investing in Shadow Beverages.[231] Before investing, Mr. and Mrs. Salganick were not informed about the GNC Judgment, that Shadow Beverages had defaulted on previous notes, or that Mr. Martinez had failed to perform on prior personal guaranties.[232] The note was to pay $7,500 in interest and was due on July 15, 2014, at which time Shadow Beverages defaulted on the note.[233] As of the date of the hearing, no payments had been made to Mr. and Mrs. Salganick on this note.[234]

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[221] Exhs. S-44, S-45, S-89 at 266.
[222] Tr. at 174.
[223] Exh. S-44, S-89 at 267.
[224] Tr. at 175; Exh. S-89 at 267.
[225] Exh. S-89 at 268.
[226] Exh. S-44, S-89 at 267.
[227] Exh. S-74.
[228] Exh. S-46, S-47.
[229] Exh. S-46.
[230] Exh. S-48.
[231] Exh. S-89 at 269.
[232] *Id.* at 269-270.
[233] Exh. S-46, S-89 at 268-269.
[234] Exh. S-74.

Darrell DeMello (Investment 12)

On February 24, 2014, Darrell DeMello received a Shadow Beverages promissory note reflecting his investment of $135,000.[235] Catherine Leyen worked with Mr. DeMello, who attempted to raise capital for Shadow Beverages through his company, Market Access India, pursuant to a finder's fee agreement, though he never received any money from that agreement.[236] Mr. DeMello did not have a management role with Shadow Beverages.[237] Mr. Peterson brought Mr. DeMello to Shadow Beverages and Mr. Martinez spoke with him about finding capital, Shadow Beverages' business plan and the company's need for capital before he invested.[238] The note was to pay $22,500 in interest after a three month term.[239] As of the date of the hearing, Shadow Beverages had paid Mr. Demello only $1,250 on the note.[240]

Reed Hatkoff (Investment 13)

Arizona accredited investor Reed Hatkoff invested $100,000 in a Shadow Beverages promissory note on March 21, 2014.[241] Mr. Hatkoff had been an owner of a securities broker-dealer firm.[242] The note was signed for Shadow Beverages by Mr. Martinez as Manager.[243] As a condition of the note, Mr. Hakoff received collateral including security interests in Mr. Martinez's interest in Shadow Beverages, an Ameritrade account of Mr. Martinez, certain Shadow Beverages purchase orders and receivables, and the company's inventory in its "No Fear" product line.[244] Mr. Hatkoff obtained information from Mr. Peterson about Shadow Beverages prior to making his investment.[245] Mr. Hatkoff also spoke with Mr. Martinez by phone to request a financial statement and some other documentation prior to investing.[246] The financial statement provided by Mr. Martinez asserted that he was not a guarantor for any company and that he did not have any judgments entered against him.[247]

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[235] Tr. at 135.
[236] Tr. at 35-37, 55, 141.
[237] Exh. S-89 at 287.
[238] Tr. at 137-138, 140-141.
[239] Tr. at 135-136.
[240] Tr. at 51-52, 136-137.
[241] Tr. at 65-66; Exhs. S-49, S-50.
[242] Tr. at 76.
[243] Exhs. S-49, S-89 at 276.
[244] Tr. at 67-68; Exhs. S-51, S-89 at 280-281.
[245] Tr. at 60-61; Exh. S-89 at 274, 277.
[246] Tr. at 61-62.
[247] Tr. at 70; Exh. S-52.

Prior to investing, Mr. Hatkoff was not informed that GNC had a judgment against Shadow Beverages, and he would not have made the investment if he was aware of this information.[248] Also prior to investing, Mr. Hatkoff was not informed that other parties held security interests in Shadow Beverages' accounts receivable and product inventory, or that Shadow Beverages had defaulted on prior notes, information that Mr. Hatkoff would have considered important in making the investment.[249] Mr. Hatkoff was to receive a return of his principal and $15,000 in interest on the maturity date of the note, September 21, 2014, at which time Shadow Beverages defaulted on the note.[250] Subsequently, Mr. Hatkoff received $45,000 when he attempted to foreclose on Mr. Martinez's personal interest in Shadow Beverages.[251]

Rick Andersen and Legacy Insurance Services Inc. – Second Investment (Investment 14)

On April 17, 2014, Mr. Andersen, through Legacy Insurance Services, Inc., made a second investment of $250,000 in a Shadow Beverages promissory note.[252] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[253] Mr. Martinez discussed this second investment in Shadow Beverages with Mr. Andersen.[254] Before making this investment, Mr. Andersen was not informed that Shadow Beverages had defaulted on previous notes or was subject to a $1,400,000 judgment against it.[255] The note was to pay $20,000 in interest and was due on May 19, 2014, at which time Shadow Beverages defaulted on the note.[256] As of the date of the hearing, no payments had been made to Mr. Andersen or Legacy Insurance Services, Inc. on this note.[257]

Catherine Leyen, Don Johnson and Ravensteed Enterprises LLC – Second Investment (Investment 15)

On May 9, 2014, Ms. Leyen and Mr. Johnson, through Ravensteed Enterprises LLC, made a

[248] Tr. at 63-64; Exh. S-89 at 277.
[249] Tr. at 68, 73-74; Exh. S-89 at 277, 279.
[250] Tr. at 66-67; Exh. S-49, S-89 at 274-275.
[251] Tr. at 72-73.
[252] Exhs. S-37, S-38, S-89 at 281.
[253] Exhs. S-37, S-89 at 282.
[254] Tr. at 173-174; Exh. S-89 at 282.
[255] Exhs. S-43, S-88 at 282-283.
[256] Exhs. S-37, S-89 at 281.
[257] Exh. S-74.

second investment of $50,000 in a Shadow Beverages promissory note.[258] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[259] This second investment was made after Ms. Leyen was told by Mr. Martinez that Shadow Beverages was expecting to bring in more income and would be promoting new brands.[260] Before making this investment, Ms. Leyen and Mr. Johnson were not informed that Shadow Beverages had defaulted on previous notes or was subject to a $1,400,000 judgment against it.[261] The note was to pay $10,000 in interest and was due on September 8, 2014, at which time Shadow Beverages defaulted on the note.[262] As of the date of the hearing, no payments had been made by Shadow Beverages on this note.[263]

Michael Crane and Debra Martin (Investment 16)

Investors Michael Crane and Debra Martin invested $50,000 in a Shadow Beverages promissory note on July 18, 2014.[264] Mr. Crane was a part owner of a vodka brand.[265] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[266] Mr. Martinez gave a personal guaranty on the note.[267] Michael Crane learned about the investment from Mr. Peterson.[268] Before investing, Michael Crane was not informed about the GNC Judgment, that Shadow Beverages had defaulted on previous notes, or that Mr. Martinez had failed to perform on prior personal guaranties.[269] The note was to pay $7,500 in interest and was due on October 18, 2014, at which time Shadow Beverages defaulted on the note.[270] As of the date of the hearing, no payments had been made by Shadow Beverages on this note.[271]

Kurt Moore (Investment 17)

Accredited Investor Kurt Moore invested $100,000 in a Shadow Beverages promissory note on

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[258] Exhs. S-41, S-42, S-89 at 284.
[259] Exh. S-41.
[260] Tr. at 49.
[261] Tr. at 45, 52; Exh. S-89 at 286.
[262] Exhs. S-41, S-89 at 284-285.
[263] Tr. at 51-52; Exh. S-74.
[264] Exhs. S-53, S-54.
[265] Tr. at 177.
[266] Exhs. S-53, S-89 at 290.
[267] Exhs. S-55, S-89 at 291.
[268] Tr. at 151; Exh. S-89 at 289-290.
[269] Exh. S-89 at 290-291.
[270] Exhs. S-53, S-89 at 289.
[271] Exh. S-74.

July 18, 2014.[272] Mr. Moore was a part owner of a vodka brand.[273] The note was executed in Phoenix, Arizona, where it was signed for Shadow Beverages by Mr. Martinez as President.[274] Mr. Martinez gave a personal guaranty on the note.[275] Mr. Peterson discussed the note with Mr. Moore.[276] Before investing, Mr. Moore was not informed about the GNC Judgment, that Shadow Beverages had defaulted on previous notes, or that Mr. Martinez had failed to perform on prior personal guaranties.[277] Mr. Moore invested because he believed the note offered a good return on his investment.[278] The note was to pay $15,000 in interest and was due on October 17, 2014, at which time Shadow Beverages defaulted on the note.[279] As of the date of the hearing, no payments had been made by Shadow Beverages on this note.[280]

IV. Legal Argument

A. Conforming the Notice to the Evidence

At the hearing, the Division moved to conform the Notice to the evidence of record.[281] Specifically, the Division sought to include the investment of Darrell DeMello as part of the allegations in the Notice.[282] Mr. Martinez objected to the Division's motion and argued that the accuracy of Mr. Beliak's summarized investor information, Exhibit S-74, would be called into question.[283] The Division argued that Mr. Beliak had not received a promissory note for Mr. DeMello from Shadow Beverages and the Division had no prior knowledge that Mr. DeMello was an investor.[284] At hearing, the Administrative Law Judge took the matter under advisement and asked the parties to include their arguments regarding the motion as part of their closing briefs.[285]

In its Post-Hearing Brief, the Division argues that, pursuant to A.A.C. R14-3-101(A), Rule

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[272] Tr. at 86-87; Exhs. S-56, S-57.
[273] Tr. at 177.
[274] Exh. S-56.
[275] Exh. S-58.
[276] Exh. S-89 at 291-292.
[277] Tr. at 88; Exh. S-89 at 292-293.
[278] Tr. at 87.
[279] Exhs. S-56, S-89 at 291-292.
[280] Exh. S-74.
[281] Tr. at 181-182.
[282] *Id.*
[283] Tr. at 182-184.
[284] Tr. at 184-185.
[285] Tr. at 185-186.

15(b) of the Arizona Rules of Civil Procedure applies, as no procedure for conforming pleadings to the evidence is set forth by law, the Commission's Rules of Practice and Procedure, or Commission regulation or order.[286] Citing *Continental National Bank v. Evans*, 107 Ariz. 378, 381, 489 P.2d 15, 18 (1971) and *Beckwith v. Clevenger*, 89 Ariz. 238, 240, 360 P.2d 596, 597 (1961), the Division contends that amendments are to be liberally permitted to promote judicial economy and that the issue of Mr. DeMello's investment was tried by the consent of the parties as no objection was raised to the testimony on the subject. The Division further contends that the motion should be granted as Mr. Martinez claimed neither prejudice nor surprise by the issue and, to the contrary, he was prepared to testify about Mr. DeMello's investment.

The Post-Hearing Brief filed by the Martinezes presents no arguments opposing the Division's motion to conform the Notice to the evidence of record.

The Commission's rules allow for the amendment or correction of formal documents and provide that "[f]ormal documents will be liberally construed and defects which do not affect substantial rights of the parties will be disregarded."[287] Motions are to conform insofar as practicable with the Arizona Rules of Civil Procedure.[288] The Arizona Rules of Civil Procedure apply when procedure is not otherwise set forth by law, by the Commission's Rules of Practice and Procedure, or by regulations or orders of the Commission.[289] Amendments under Rule 15(b) allow a case to ultimately be tried on its merits and such amendments should be liberally allowed in the interests of justice.[290] Whether an issue has been tried under Rule 15(b) will depend upon the facts of the case, but the record must have some affirmative showing that the unpleaded issue was reached.[291] A failure to object to the

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[286] Though amended effective January 1, 2017, as of the date of the hearing, Rule 15(b) of the Arizona Rules of Civil Procedure provided:
When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment, but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice the party in maintaining the party's action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

[287] A.A.C. R14-3-106(E).

[288] A.A.C. R.14-3-106(K).

[289] A.A.C. R.14-3-101(A).

[290] *Evans*, 107 Ariz. at 381, 489 P.2d at 18.

[291] *Hill v. Chubb Life American Ins. Co.*, 182 Ariz. 158, 161, 894 P.2d 701, 704 (1995).

introduction of evidence on the ground that it is not within the issues sufficiently implies consent to try such issues.[292] If the amendment would cause prejudice or surprise, it may be properly refused.[293]

In this case, the Division's witness, Ms. Leyen testified on direct examination to investments made by "Darrell," who suffered financial hardship as a result.[294] At the conclusion of the Division's direct examination, the Administrative Law Judge asked Ms. Leyen for clarification as to the identity of "Darrell," whom Ms. Leyen testified to be Mr. DeMello, an individual who gave "a lot of money" to Mr. Martinez.[295] On cross-examination, Mr. Martinez asked Ms. Leyen if she was aware that Mr. DeMello had an agreement with Shadow Beverages for fees for raising capital, which she acknowledged.[296] In his direct testimony, Mr. Martinez testified that Mr. DeMello had invested in Shadow Beverages and he testified at length about Mr. DeMello's investment on cross-examination.[297] Significant testimony regarding Mr. DeMello's investment was given at the hearing without an objection from Mr. Martinez or Mrs. Martinez. Accordingly, we find the issue of Mr. DeMello's investment was tried by the implied consent of the parties.

Further, the Respondents have raised no objection for surprise or prejudice resulting from the Division's motion to conform. At the hearing, Mr. Martinez objected to the motion as being contradictory to the information included in the Division's investor list summary exhibit and challenged the veracity of that exhibit accordingly.[298] As for the Division's exhibit, Mr. Martinez was given an opportunity to cross-examine the Division's accountant as to its accuracy.[299] Mr. Martinez further had the opportunity to testify and introduce exhibits to challenge the information presented in the Division's exhibit list. Mr. Martinez has not set forth a basis to strike the Division's exhibit or to deny the Division's motion. Accordingly, the Division's motion to conform is granted and we shall consider the investment of Mr. DeMello in rendering our decision.

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[292] *In re McCauley's Estate*, 101 Ariz. 8, 18, 415 P.2d 431, 441 (1966).
[293] *See Bujanda v. Montgomery Ward & Co. Inc.*, 125 Ariz. 314, 316, 609 P.2d 584, 586 (App. 1980); *Eng v. Stein*, 123 Ariz. 343, 347, 599 P.2d 796, 800 (1979).
[294] Tr. at 52-53.
[295] Tr. at 53-54.
[296] Tr. at 55.
[297] Tr. at 115, 132-149.
[298] Tr. at 182-185; Exh. S-74.
[299] Tr. at 106-107.

B. Classification of the Investments

1. Shadow Beverages Notes

The Division contends that the notes sold by Shadow Beverages are securities for registration purposes. Notes are included within the statutory definition of a security[300] and the Arizona Supreme Court has held that notes are therefore subject to registration requirements unless exempted by statute.[301] The Division contends that the notes are also securities under the Act's anti-fraud provisions. The Division analyzes the Shadow Beverages notes under the "family resemblance" test, adopted as law in Arizona in *MacCollum v. Perkinson*, 185 Ariz. 179, 913 P.2d 1097 (App. 1996). Under *MacCollum*, the Division contends that a note is presumed to be a security for anti-fraud purposes but that presumption may be rebutted "by showing that a note bears a strong resemblance to an instrument that is not intended to be regulated as a security based on four factors: 1) the motives of the parties, 2) the plan of distribution, 3) the public's reasonable expectations, and 4) the existence of a risk-reducing factor such as another regulatory scheme."[302] The Division contends that these factors do not rebut the presumption that the Shadow Beverages notes are securities: Shadow Beverages was motivated to raise capital to run the company and produce product while investors were motivated by the promise of returns; Shadow Beverages' plan of distribution was to raise capital with the help of Mr. Peterson, whom the company believed to be a licensed investment advisor; and there is no alternative regulatory scheme or risk-reducing factor for the Shadow Beverages notes other than securities regulation. The Martinezes raise no contentions as to whether the Shadow Beverages notes are securities.

The Division correctly states the standard applied by the Arizona Supreme Court with regard to determining whether a note is a security for registration purposes, namely that a note is a security unless otherwise exempted by statute.[303] Therefore, the Shadow Beverages notes are securities, for registration purposes, unless exempt under the Act. We specifically consider the applicability of exemptions in a separate section, *infra*.

When analyzing a note in terms of whether it is a security for the purposes of the antifraud

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[300] A.R.S. § 44-1801(26).
[301] *State v. Tober*, 173 Ariz. 211, 213, 841 P.2d 206, 209 (1992).
[302] Division's Post-Hearing Brief at 17.
[303] *Tober*, 173 Ariz. at 213, 841 P.2d at 209.

provisions of the Act, the Arizona Court of Appeals has adopted the "family resemblance" test,[304] which was used under federal securities law by the United States Supreme Court in *Reves v. Ernst & Young*, 494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990). The test begins with the presumption that every note is a security.[305] This presumption can be rebutted if a review of four factors establishes a "family resemblance" to a list of instruments that are not securities, or if those factors establish a new category of instrument that should be added to the list.[306] This list of notes "that are not securities includes the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business" as well as "notes evidencing loans by commercial banks for current operations"[307] The four factors considered are: 1) the motivations prompting a reasonable buyer and seller to enter the transaction; 2) the plan of distribution of the instrument to determine if it is an instrument subject to common speculation or investment; 3) the reasonable expectations of the investing public; and 4) whether some risk-reducing factor, such as the existence of another regulatory scheme, would render application of the Securities Act unnecessary.[308] We may also consider the notes in light of the economic realities of the transaction.[309]

Under the first factor, a note is more likely a security "[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate."[310] Conversely, a note is less likely to be a security "[i]f the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose."[311]

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[304] *MacCollum*, 185 Ariz. at 187, 913 P.2d at 1105.
[305] *Reves*, 494 U.S. at 65, 110 S. Ct. at 951.
[306] *Id.* Since both inquiries involve application of the same four-factor test, they "essentially collapse into a single inquiry." *S.E.C. v. Wallenbrock*, 313 F.3d 532, 537 (9th Cir. 2002).
[307] *Reves*, 494 U.S. at 65, 110 S. Ct. at 951 (citations omitted).
[308] *Reves*, 494 U.S. at 66-67, 110 S. Ct. at 951-952; *MacCollum* 185 Ariz. at 187-188, 913 P.2d at 1105-1106.
[309] *Wallenbrock*, 313 F.3d at 538.
[310] *Reves*, 494 U.S. at 66, 110 S. Ct. at 951-952.
[311] *Reves*, 494 U.S. at 66, 110 S. Ct. at 952.

One investor, Mr. Jarus, was told that the biggest issue facing Shadow Beverages was finding capital, to run the company and for production purposes.[312] Another investor, Mr. Hatfield, was told Shadow Beverages needed short-term money to create product.[313] Raising capital was an ongoing concern for Shadow Beverages and executives were not being paid.[314] Funds raised through the Shadow Beverages notes reflect the company's ongoing need to acquire capital to maintain business operations. This factor weighs in favor of finding that the Shadow Beverages notes are securities.

The second *Reves* factor is the plan of distribution. Offers and sales to a broad segment of the public will establish common trading in an instrument.[315] "If notes are sold to a wide range of unsophisticated people, as opposed to a handful of institutional investors, the notes are more likely to be securities."[316] However, the number of investors is not dispositive, but must be weighed against the purchasers' need for the protection of the securities laws.[317] Shadow Beverages hired Richard Peterson as Executive Vice President of Business Development under the belief that he was a licensed investment advisor and the company established a finder's fee arrangement with him for all introductions that produced capital for Shadow Beverages.[318] Shadow Beverages placed no limitations or guidelines on how investors were found.[319] Shadow Beverages sold notes in sixteen transactions to fourteen different individual investors or groups. While some investors had business experience in the beverage industry or securities, other purchasers included a police officer, a professional off-road truck racer and an investor in gold. The protections of securities laws would have benefited the investors in this case. The second factor supports a finding that the Shadow Beverages notes are securities.

The third factor requires us to consider the reasonable expectations of the investing public. When a note seller calls the note an investment, it is generally reasonable for a prospective purchaser to take the offeror at its word, but when note purchasers are expressly put on notice that a note is not an investment, it is usually reasonable to conclude that the investing public would not expect the notes

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[312] Exh. S-88 at 188.
[313] Tr. at 61.
[314] Exhs. S-64, S-65, S-68, S-69, S-89 at 304-311.
[315] *Reves*, 494 U.S. at 68, 110 S. Ct. at 953.
[316] *U.S. S.E.C. v. Zada*, 787 F.3d 375, 381 (6th Cir. 2015).
[317] *McNabb v. S.E.C.*, 298 F.3d 1126, 1132 (9th Cir. 2002).
[318] Exhs. S-71, S-72, S-87 at 53-54.
[319] Exh. S-87 at 82, 129.

to be securities.[320] Here, the notes referred to the purchasers not as investors, but as "Holders"[321] or "Lenders."[322] Generally, the notes were of short durations, with the longest coming due at one year[323] while seven others came due in three months or less.[324] Only two of the purchasers testified, with one considering her note to be an investment.[325] The other purchaser testified that he considered himself to be a lender and creditor of Shadow Beverages with the note being a short-term hard money loan where the borrower did not have time to go through the due diligence required by a bank lender.[326] We find that a reasonable investor may have concluded that the Shadow Beverages notes were investments, or, alternatively, could have considered the notes to be short-term loans. Accordingly, we find the third factor to be neutral in determining whether the Shadow Beverages notes are securities.

The fourth factor requires us to look at risk-reducing factors that would diminish the need for protection under the Act, such as the presence of other regulatory schemes, collateral or insurance.[327] Many of the Shadow Beverages notes came with personal guaranties from Mr. Martinez. The presence of personal guaranties does not make the Shadow Beverages notes resemble any of the categories in *Reves*. In considering the economic realities of the transactions, we note that Mr. Tunnell was able to include an additional cause of action in his civil complaint based upon personal guaranties, but the guaranties did little to protect the purchasers from default or to enforce repayment. Accordingly, the personal guaranties cannot be seen as alleviating the need for protection under the Act.

However, three of the transactions included security agreements. David Kelly, with Canis Major Development, and Rick Andersen, in his first investment, were both assigned a limited security interest in product inventory and accounts receivable.[328] Reed Hatkoff received collateral including security interests in Mr. Martinez's interest in Shadow Beverages, an Ameritrade account of Mr.

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[320] *Stoiber v. S.E.C.*, 161 F.3d 745, 751 (D.C. Cir. 1998).
[321] Exhs. S-4, S-7.
[322] Exhs. S-11, S-18, S-22, S-24, S-28, S-34, S-37, S-41, S-44, S-46, S-49, S-53, S-56.
[323] Rick Andersen (Exh. S-34).
[324] Ronald Barrett, 57 days (Exh. S-22), David Kelly and Canis Major Development, 60 days (Exh. S-28), James Stephensen, three months (Exh. S-44), Darell DeMello, three months (Tr. at 136), Rick Andersen and Legacy Insurance Services, Inc., 32 days (Exh. S-37), Michael Crane and Debra Martin, three months (Exh. S-53), and Kurt Moore, three months (Exh. S-56).
[325] Tr. at 34.
[326] Tr. at 61, 64-65.
[327] *Resolution Trust Corp. v. Stone*, 998 F.2d 1534, 1539 (10th Cir. 1993).
[328] Exhs. S-31 and S-36.

Martinez, and some of Shadow Beverages' inventory and accounts receivable.[329] Mr. Hatkoff made a Uniform Commercial Code filing of his security agreement and he was able to obtain a payment of $45,000 from Mr. Martinez when he sought to foreclose on Mr. Martinez's interest in the company.[330]

"[T]he existence of collateral is significant as a risk-reducing factor."[331] In considering the economic realities of the worth of the collateral, we note the pre-existing Factoring Agreement which had given a $1 million security interest in collateral including present and future accounts receivable and the proceeds of inventory.[332] However, Shadow Beverages still had assets of value, as evidenced by the $12.2 million sale of its "No Fear" beverage license in March 2015, which had generated approximately $4.3 million in revenue in 2014.[333] The three transactions with security agreements bear a resemblance to items on the *Reves* list, namely, short-term notes secured by an assignment of accounts receivable and short-term notes secured by a lien on a small business or some of its assets.

Under Arizona law, the Shadow Beverages notes are presumed to be securities. Having considered the family resemblances test under *Reves*, we conclude that the notes issued in three of the investments cannot be considered securities under the antifraud provisions of the Act as they strongly resemble instruments not intended to be regulated as securities.[334] The remaining thirteen notes do not resemble instruments on the *Reves* list, and the evidence does not establish that they should be a category added to that list. Accordingly, we find that thirteen of the notes are securities subject to the antifraud provisions of the Act.

2. Shadow Beverages Loan Agreement

The Division contends that the Loan Agreement Shadow Beverages executed with Ms. Leyen and Mr. Johnson is a security because it is an investment contract. The Division applies the *Howey*[335] test to determine the Loan Agreement is an investment contract if it involves an investment of money in a common enterprise with the expectation of profits from the managerial efforts of others. The

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[329] Exh. S-51.
[330] Tr. at 72-73; Exhs. S-51, S-89 at 280.
[331] *Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 585 (6th Cir. 2000).
[332] Exh. S-25.
[333] Tr. at 127-129; Exh. M-6.
[334] Specifically, these investments are David Kelly and Canis Major Development (Investment 7), the first investment of Rick Andersen (Investment 8), and the investment of Reed Hatkoff (Investment 13).
[335] *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946).

Division concludes the Loan Agreement meets the *Howey* test because Ms. Leyen and Mr. Johnson invested expecting profits, profits would be based on Shadow Beverages' successful production and sale of product, and Ms. Leyen and Mr. Johnson had no managerial role at the company. The Respondents make no contention regarding whether the Loan Agreement is a security.

Investment contracts are included within the statutory definition of a security.[336] The elements of what constitutes an investment contract have been set forth in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), adopted as law in Arizona in *Rose v. Dobras*, 128 Ariz. 209, 624 P.2d 887 (App. 1981). Under *Howey* and *Rose*, an investment contract will be found in "any situation where (1) individuals are led to invest money (2) in a common enterprise (3) with the expectation that they will earn a profit solely through the efforts of others."[337]

Ms. Leyen considered the Loan Agreement to be an investment which she made after Mr. Martinez told her that Shadow Beverages needed money for a production run.[338] These facts satisfy the first prong of the *Howey* test. The second prong requires a finding of a common enterprise. "A common enterprise exists when 'the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.'"[339] Under the terms of the Loan Agreement, Ms. Leyen and Mr. Johnson would receive a profit of $5,000.[340] Pursuant to the Loan Agreement, the invested funds would be used for the production of forty thousand cases of Shadow Beverages' product with Ms. Leyen and Mr. Johnson not receiving payments on the Loan Agreement until after Shadow Beverages began to receive proceeds from the sale of these cases.[341] Since both the investors and the company would receive financial benefit from the production and sale of Shadow Beverages' product, a common enterprise exists. The last prong of the *Howey* test requires that investors expect profits based solely on the efforts of others. Ms. Leyen and Mr. Johnson did not have management roles at Shadow Beverages,[342] and they were therefore reliant upon the efforts of the

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[336] A.R.S. § 44-1801(26).
[337] *Rose*, 128 Ariz. at 211, 624 P.2d at 889.
[338] Tr. at 34, 37-38.
[339] *Vairo v. Clayden*, 153 Ariz. 13, 17, 734 P.2d 110, 114 (App. 1987), quoting *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 n. 7 (9th Cir.).
[340] Exh. S-39.
[341] *Id.*
[342] Exh. S-88 at 248.

company's management to successfully market and sell the product to receive payment on the Loan Agreement. The Loan Agreement meets the requirements set forth under *Howey*, making it an investment contract and, therefore, a security.

3. Exemptions

The Respondents raise no contentions that the promissory notes or loan agreement are exempt from being considered securities. The Division argues that the Respondents failed to make a Form D notice filing with the Commission, a requirement after making a securities sale for several types of exemptions.[343] The Division contends that the Respondents cannot avail themselves of any exemptions that prohibit the issuer from engaging in general solicitation,[344] as Shadow Beverages did not limit Mr. Peterson on how he was to locate investors and he contacted potential investors with whom he did not have a pre-existing relationship.[345] The Division further contends that the Respondents failed to limit themselves to accredited or sophisticated investors, and therefore they cannot avail themselves of any exemptions for which investor status is a requirement.[346]

Under A.R.S. § 44-2033, the burden of proof to establish an exemption from registration is borne by the party raising the defense. The Respondents have not asserted the applicability of any exemption. Accordingly, we find that none of the seventeen investments were exempt from registration requirements.

C. Registration Violations

Under A.R.S. § 44-1841, it is unlawful to sell or offer for sale within or from Arizona any securities unless those securities have been registered or are exempt from registration. Shadow Beverages' securities have not been registered by the Commission.[347] Under A.R.S. § 44-1842, it is unlawful for any dealer or salesman to sell or offer to sell any securities within or from Arizona unless the dealer or salesman is registered. Shadow Beverages and Mr. Martinez were not registered as securities dealers or salesmen by the Commission.[348] The record does not establish the presence of any

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[343] *See, e.g.*, R14-4-126(D); R14-4-140(L).
[344] *See, e.g.*, 17 C.F.R. §230.502(c); R14-4-126(C)(3).
[345] Tr. at 60; Exh. S-87 at 81-82, 129.
[346] *See, e.g.*, 17 C.F.R. §230.506(b)(ii); R14-4-126(F)(2)(b).
[347] Exh. S-1a.
[348] Exhs. S-1a, S-1b.

exemptions to the registration requirements.

The evidence established that all of the investments were executed by Mr. Martinez signing on behalf of Shadow Beverages except for the first note of Mr. Tunnell and the note of Mr. DeMello.[349] The first note for Mr. Tunnell was signed for Shadow Beverages by Sam Jones.[350] Mr. Martinez participated in the offer and sale of this note by providing a personal guaranty of the note to Mr. Tunnell.[351] A promissory note was executed by Shadow Beverages for Mr. DeMello, but the record does not establish who executed this note on behalf of Shadow Beverages.[352] However, the record does establish that prior to Mr. DeMello making his investment, Mr. Martinez discussed Shadow Beverages' business plan, the company's need for capital, and how Mr. DeMello's investment funds would be used by the company.[353] The evidence of record established that all seventeen of the investments involved offers and sales made by Shadow Beverages and Mr. Martinez.

Mr. Martinez contends that he should not be subject to any remedies involving registration violations because he believed Mr. Peterson was properly licensed and Mr. Peterson reported to Mr. Martinez and Shadow Beverages that an attorney told him they were acting within SEC guidelines.[354] The Division notes that Mr. Martinez failed to verify Mr. Peterson's licensure or confirm the attorney's advice.

Mr. Martinez argues that a good faith reliance on Mr. Peterson's statements and the advice of counsel should act as a defense to the alleged registration violations. However, this argument relies upon intent being a necessary element to find a registration violation. Neither A.R.S. § 44-1841 nor § 44-1842 contain language requiring a culpable mental state to commit the offense. Under A.R.S. § 13-202(B), a statutory offense that does not set forth a culpable mental state will be one of strict liability.[355] Since A.R.S. §§ 44-1841 and 44-1842 are strict liability offenses, whether Respondents acted in good

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[349] Exhs. S-4, S-11, S-18, S-22, S-24, S-28, S-34, S-37, S-39, S-41, S-44, S-46, S-49, S-53, S-56.
[350] Exh. S-7.
[351] Exhs. S-7, S-9.
[352] Tr. at 135.
[353] Tr. at 137-138, 140-141.
[354] Tr. at 122-124, 132; Exhs. S-87 at 52-55, M-05.
[355] A.R.S. § 13-202 provides, in pertinent part:
B. If a statute defining an offense does not expressly prescribe a culpable mental state that is sufficient for commission of the offense, no culpable mental state is required for the commission of such offense, and the offense is one of strict liability unless the proscribed conduct necessarily involves a culpable mental state. If the offense is one of strict liability, proof of a culpable mental state will also suffice to establish criminal responsibility.

faith is irrelevant to determining whether the Respondents violated those statutes.[356] Accordingly, we find that all seventeen of the investments constituted violations of A.R.S. §§ 44-1841 and 44-1842 committed by Shadow Beverages and Mr. Martinez.

D. Anti-Fraud Violations

The Division contends that Mr. Martinez and Shadow Beverages engaged in multiple violations of the antifraud provisions of the Securities Act, A.R.S. § 44-1991(A). A.R.S. § 44-1991 provides, in pertinent part:

> It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, including securities exempted under section 44-1843 or 44-1843.01 and including transactions exempted under section 44-1844, 44-1845 or 44-1850, directly or indirectly to do any of the following:
>
> 1. Employ any device, scheme or artifice to defraud.
> 2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
> 3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

An issuer of securities has an affirmative duty not to mislead potential investors.[357] Under A.R.S. § 44-1991(A)(2), a material fact is one that "would have assumed actual significance in the deliberations of the reasonable buyer."[358] Materiality will also be found when there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as

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[356] "[A]dvice of counsel is not a defense to a strict liability violation of the Act. It can, however, be considered by the Commission as a mitigating factor in determining penalties and sanctions." Decision No. 58259 (April 8, 1993) at 11.
[357] *Trimble v. Am. Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (App. 1986).
[358] *Aaron v. Fromkin*, 196 Ariz. 224, 227, 994 P.2d 1039, 1042 (App. 2000).

having significantly altered the 'total mix' of information made available."[359]

1. Prior Defaults

The Division contends that all Shadow Beverages' investors were given a date for repayment of their investments, however, Mr. Martinez and Shadow Beverages omitted to tell many of the investors that Shadow Beverages had defaulted on all of the earlier notes. The Division contends that this omission was misleading because it implied that Shadow Beverages had the means to repay investors when their notes came due, but the history of defaults would show this implication to be false. The Division argues that since this information would have been significant to Ms. Leyen and Mr. Hatkoff in making their decision to invest, it would have been material to a reasonable investor.

In his Post-Hearing Brief, Mr. Martinez contends that he and Mr. Karas planned to write an extension to Mr. Karas' note, which was not done because of Mr. Karas' ill health. Mr. Martinez also contends that Shadow Beverages was advised by counsel that once the company paid Mr. Tunnell and an order not to execute the judgment was filed, "it was as if the judgment never happened."[360]

In its Reply Brief, the Division argues that even if Mr. Karas informally agreed to an extension, and the settlement with Mr. Tunnell created a legal fiction regarding the defaults on his notes, information of the defaults would have been significant to the deliberations of a reasonable investor. The Division further contends that Shadow Beverages defaulted on every note, and those other defaults would still be material regardless of the situations regarding the defaults on the notes of Mr. Karas and Mr. Tunnel.

The Division does not assert any omissions of prior default regarding the first investment, Mr. Karas, or for the investments of Mr. Jarus, Mr. Kelly, and Mr. DeMello. Having found the notes for the investment of Mr. Hatkoff and the first investment of Mr. Andersen are not securities for the purposes of the anti-fraud provisions of the Act, we dismiss the allegations as to those two investments. Of the remaining investments, the evidence of record established that Mr. Martinez discussed the Shadow Beverages investment with investors, by himself or with others, and omitted information

[359] *Caruthers v. Underhill*, 230 Ariz. 513, 524, 287 P.3d 807, 818 (App. 2012), quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976).

[360] Respondents' Post-Hearing Brief at 10.

regarding prior defaults in eight investments.[361] In another three investments, Mr. Martinez did not speak with investors, but he signed the notes for Shadow Beverages which stated the repayment dates while omitting to give information regarding prior defaults.[362]

Since the promissory notes contained payment dates, the investors had a reasonable expectation of receiving repayment on those dates.[363] However, the fact that Shadow Beverages had defaulted on prior notes would cast doubt as to whether the company could timely repay the notes of new investors. We find that a reasonable investor would have found information about Shadow Beverages' prior defaults to be significant to one's deliberations as the prior defaults reflected an added risk to the investment. We do not consider the circumstances surrounding the defaults on the notes of Mr. Karas and Mr. Tunnell as detracting from the significance of their omission. On the contrary, the surrounding circumstances could have been explained to investors so they could weigh the value of this purported mitigating information in their deliberations. We find omission of the fact of the prior defaults to investors constituted fraud under A.R.S. § 44-1991(A)(2). Accordingly, Shadow Beverages and Mr. Martinez are responsible for fraud for the omission of prior defaults in eleven investments.

2. Personal Guaranties

The Division contends that Shadow Beverages and Mr. Martinez stated to Mr. Jarus, Mr. Kelly, Mr. and Mrs. Salganack, Mr. Crane, and Mr. Moore that Mr. Martinez personally guaranteed their notes, however they omitted to state that Mr. Martinez had failed to perform on other personal guaranties of Shadow Beverages' notes. The Division contends that the omissions were misleading because the personal guaranties were given to create confidence in the transactions, but knowledge that Mr. Martinez had failed to perform on past guaranties would have undermined this confidence. The Division argues that the omitted information would have been material to a reasonable investor as it would have changed the apparent risk of the investment, and risk is fundamentally significant to an

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[361] Brent Tunnell twice (Tr. at 165; Exh. S-88 at 173-175), Ronald Barrett (Tr. at 168; Exh. S-88 at 198-199), Gervasi/Van Kilsdonk (Tr. at 85, 169; Exh. S-88 at 201), Catherine Leyen and Donald Johnson twice (Tr. at 34, 37-38, 49, 52; Exhs. S-88 at 250, S-89 at 286), James Stephensen (Tr. at 175; Exh. S-89 at 267-268), Rick Anderson and Legacy Insurance Services, Inc. (Tr. at 173-174; Exh. S-89 at 282-283).

[362] Jason and Robbyn Salganick (Tr. at 175-176; Exhs. S-46, S-89 at 269), Michael Crane and Debra Martin (Tr. at 176; Exhs. S-53, S-89 at 289-290), Kurt Moore (Tr. at 88, 177; Exhs. S-56, S-89 at 291-292).

[363] The Loan Agreement with Ms. Leyen and Mr. Johnson did not have a set date for repayment, but was to be paid in bimonthly installments following initial sales of Shadow Beverages' production run. Exh. S-39.

investment decision. In their Post-Hearing Brief, the Martinezes raise no specific contentions regarding the allegation of fraud from omission of the failure to perform on personal guaranties.

Having found Mr. Kelly's note is not a security for the purposes of anti-fraud violations, we dismiss the anti-fraud allegation as to his investment. The evidence of record established that Mr. Martinez provided a personal guaranty on the first note of Mr. Tunnell and that Mr. Martinez failed to perform on the guaranty when Shadow Beverages defaulted on the note on August 17, 2010.[364] Following the first investment of Mr. Tunnell, Mr. Martinez provided a written guaranty for the note of Scott Jarus, and while Mr. Martinez discussed the Shadow Beverages investment with Mr. Jarus, he omitted to state his failure to perform on the personal guaranty he gave Mr. Tunnell.[365] In another three investments, Mr. Martinez did not speak with investors, but he provided written guaranties on the notes while omitting to provide information regarding his past failures to perform on personal guaranties.[366]

We agree with the Division's contention that the personal guaranties of Mr. Martinez were used to create confidence in the Shadow Beverages investments. The degree of confidence a reasonable investor would derive from a personal guaranty would undoubtedly be affected by the knowledge that personal guaranties had not been honored in the past. We find that information regarding prior failures to perform on personal guaranties would have been a material fact for those investors to whom guaranties were given, the omission of which constituted fraud under A.R.S. § 44-1991(A)(2). Accordingly, Shadow Beverages and Mr. Martinez are responsible for fraud for the omission of prior failures to perform on personal guaranties in four investments.

3. Existing Security Interests.

The Division contends that Shadow Beverages and Mr. Martinez stated to Mr. Kelly, Mr. Anderson, and Mr. Hatkoff that Shadow Beverages would grant them security interests in its product inventory and accounts receivable, however, they omitted to state that Shadow Beverages had previously granted a bank a $1,000,000 security interest in the same collateral. The Division contends that the omissions were misleading because the purpose of the security interests was to create

[364] Exhs. S-9, S-13 at ACC000325, S-16, S-88 at 178.
[365] Exhs. S-20, S-88 at 188, 191.
[366] Jason and Robbyn Salganick (Tr. at 175-176; Exhs. S-48, S-89 at 269-270), Michael Crane and Debra Martin (Tr. at 151, 176; Exhs. S-55, S-89 at 289-291), Kurt Moore (Tr. at 88, 177; Exhs. S-58, S-89 at 291-293).

confidence in the transaction by giving the investors an additional recourse to recover their money, but knowing that there was a large prior security interest would cast doubt on whether there would be sufficient collateral to secure their investments. The Division contends that because it would have been significant to Mr. Hatkoff's decision to invest, it would have been material to a reasonable investor.

Since we have concluded that the Shadow Beverages notes granting security interests to Mr. Kelly, Mr. Anderson, and Mr. Hatkoff did not meet the test of a security for purposes of the anti-fraud provisions of the Act, these allegations are dismissed.

4. GNC Judgment

The Division contends that Shadow Beverages and Mr. Martinez stated to Mr. Andersen (in his second note), Ms. Leyen, Mr. Johnson, Mr. and Mrs. Salganick, Mr. Hatkoff, Mr. Crane, and Mr. Moore that Shadow Beverages would repay them by a particular date, however, they omitted to state that a $1,400,000 GNC Judgment had been awarded against Shadow Beverages. The Division contends the omission was misleading as such a large judgment against Shadow Beverages would call into question the company's ability to timely repay the investors. The Division contends that because it would have been significant to Ms. Leyen and Mr. Hatkoff in making their decision to invest, it would have been material to a reasonable investor. In their Post-Hearing Brief, the Martinezes raise no specific contentions regarding the allegation of fraud from the omission of the GNC Judgment.

Having found Mr. Hatkoff's note is not a security for the purposes of anti-fraud violations, we dismiss the anti-fraud allegation as to his investment. The evidence of record established that Mr. Martinez discussed the Shadow Beverages investment with investors, by himself or with others, and omitted information regarding the GNC Judgment in two investments.[367] In another three investments, Mr. Martinez did not speak with investors, but he signed the notes for Shadow Beverages which stated the repayment dates while omitting to give information about the GNC Judgment.[368]

As we determined above, the investors had a reasonable expectation of receiving payment on the dates stated in the promissory notes. However, the $1.4 million judgment against Shadow

[367] Rick Andersen and Legacy Insurance Services, Inc. (Tr. at 173-174; Exh. S-89 at 282-283), Catherine Leyen's and Donald Johnson's second investment (Tr. at 45, 49; Exh. S-89 at 286).

[368] Jason and Robbyn Salganick (Tr. at 175-176; Exh. S-89 at 269-270), Michael Crane and Debra Martin (Tr. at 151, 176; Exh. S-89 at 289-290), Kurt Moore (Tr. at 88, 177; Exh. S-89 at 291-292).

Beverages would have called into question the financial state of the company and its ability to make repayments as scheduled. We find that a reasonable investor would have found information about the GNC Judgment to be significant to one's deliberations as the large judgment could have posed a risk to the investment. Therefore, omission of the GNC Judgment constituted fraud under A.R.S. § 44-1991(A)(2). Shadow Beverages and Mr. Martinez are responsible for fraud for the omission of the GNC Judgment in five investments.[369]

5. Misrepresentations.

The Division contends that the statement by Shadow Beverages and Mr. Martinez to Mr. Tunnell that Shadow Beverages was not in default on any debt was untrue as the company was in default on Mr. Karas' note at the time. The Division contends that this past default would be significant to a reasonable investor as it would indicate Shadow Beverages' inability to repay the investment. Mr. Martinez contends that he discussed an extension of the note with Mr. Karas, but an extension was not executed due to Mr. Karas' ill health.

The Term Loan Agreement executed by Mr. Tunnell and Shadow Beverages, in connection with Mr. Tunnell's second investment, reads, in pertinent part:

> 3. Representations and Warranties
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> 3.1 Representations and Warranties. To induce Lender [Brent Tunnell] to establish and enter into this Loan Agreement, Borrower [Shadow Beverages] hereby represents and warrants to the Lender that so long as this Loan Agreement is in effect and until payment and performance in full of all obligations and liabilities of Borrower to Lender:
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> * * *
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> (n) Borrower is not in default in the payment of the principal or interest on any indebtedness for borrowed money, nor is it in default under any instrument or

[369] Having found Mr. Hatkoff's note is not a security for the purposes of anti-fraud violations, we dismiss the anti-fraud allegation as to his investment.

> agreement under and subject to which any indebtedness for borrowed money has been issued …[370]

The Term Loan Agreement expressly stated that Shadow Beverages was not in default on any indebtedness even though Shadow Beverages was in default on the promissory note to Mr. Karas. As we determined above, investors had a reasonable expectation of receiving payment on the dates stated in their promissory notes and information regarding prior defaults constituted a material fact. The misrepresentation made to Mr. Tunnell that Shadow Beverages was not in default constituted fraud under A.R.S. § 44-1991(A)(2). Accordingly, Shadow Beverages and Mr. Martinez are responsible for fraud for the misrepresentation of a prior default in one investment.

The Division further alleges three misrepresentations made by Shadow Beverages and Mr. Martinez to Mr. Hatkoff: that Mr. Martinez was not a guarantor for any company, that no judgment had ever been entered against Mr. Martinez, and that no one else had a security interest in certain collateral. As we have concluded that the note executed by Shadow Beverages with Mr. Hatkoff did not meet the test of a security for purposes of the anti-fraud provisions of the Act, these allegations are dismissed.

E. Control Person Liability

The Division contends that Mr. Martinez is liable as a control person, under A.R.S. § 44-1999(B), for the antifraud violations committed by Shadow Beverages.[371] The Division contends that Mr. Martinez had actual control over Shadow Beverages, as co-founder and president of the company, and evidenced by his: role as signer of the company's bank accounts, handling of day-to-day business, management of the sales and operations teams, oversight of the director of administration, and being in charge of Mr. Peterson who was Senior Vice President of Capital Acquisition. The Division further contends that Mr. Martinez failed to prove that he acted in good faith and did not induce the antifraud violations. On the contrary, the Division argues that Mr. Martinez failed to supervise or control the sales efforts of Mr. Peterson and he directly induced fraud violations through his own actions.

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[370] Exh. S-14 at SHADOW007308, SHADOW007310 (underscore in original).

[371] A.R.S. § 44-1999 provides, in pertinent part:

B. Every person who, directly or indirectly, controls any person liable for a violation of § 44-1991 or 44-1992 is liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action.

In his Post-Hearing Brief, Mr. Martinez concedes that he was "in charge of the running of the operations" of Shadow Beverages but argues that he did not have sole decision-making authority because a board of directors was in place that was responsible for approving decisions.[372] Mr. Martinez also argues that he sought legal advice and he was misled by Mr. Peterson's misrepresentation of his licensure. The Division, in its Reply Brief, argues that an entity may have multiple control persons and that Mr. Martinez, as a member of the board at Shadow Beverages, would have been part of the control group. The Division cites an Arizona Court of Appeals case holding that "the evidence need only show that the person targeted as a controlling person had the legal power, either individually or as part of a control group, to control the activities of the primary violator."[373]

A.R.S. § 44-1999(B) establishes joint and several liability for a person who directly or indirectly controls a violator of A.R.S. § 44-1991 or § 44-1992, unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action. The Arizona Court of Appeals has interpreted A.R.S. § 44-1999(B) "as imposing presumptive control liability on persons who have the *power* to directly or indirectly control the activities of those persons or entities liable as primary violators of [A.R.S.] §§ 44–1991 and –1992."[374]

The evidence of record established that Mr. Martinez was a co-founder of Shadow Beverages in 2008.[375] Mr. Martinez served as president of the company since 2010 and was part of the company's Executive Team.[376] Mr. Martinez handled the company's day-to-day business, managed the sales and operations teams, oversaw the company's director of administration, was the boss over the Senior Vice President of Capital Acquisitions, and signed finder's fee agreements on behalf of Shadow Beverages for bringing in capital and investments.[377] Based on the record, we find that Mr. Martinez was a controlling person of Shadow Beverages under A.R.S. § 44-1999(B).

A.R.S. § 44-1999(B) creates an affirmative defense for control persons who acted in good faith and did not induce the act underlying the action. A lack of scienter is not sufficient to establish the

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[372] Respondents' Post-Hearing Brief at 12.
[373] *E. Vanguard Forex, Ltd. v. Arizona Corp. Comm'n*, 206 Ariz. 399, 412, 79 P.3d 86, 99 (App. 2003).
[374] *Id.*, emphasis in original.
[375] Exhs. S-2a, S-61 at ACC000048, S-62 at SHADOW005151, S-92 at 1, S-93 at 1.
[376] Tr. at 149, 178-180; Exhs. S-61 at ACC000055, S-92 at 8, S-93 at 8.
[377] Tr. at 149-150; Exhs. S-72, S-73.

good faith prong of the defense.[378] Minimally, "controlling persons must establish that they exercised due care by taking reasonable steps to maintain and enforce a reasonable and proper system of supervision and internal controls."[379]

Here, Mr. Martinez argues good faith based upon having sought legal advice and Mr. Peterson's misrepresentation of his licensure. The evidence of record established that Mr. Martinez was Mr. Peterson's boss, but he did not closely supervise Mr. Peterson's activities.[380] Although limits were placed on what Mr. Peterson told potential investors, Mr. Martinez never provided any guidelines or limits on how Mr. Peterson found investors and he did not require that the GNC judgment be disclosed to investors.[381] Mr. Martinez received an email wherein Mr. Peterson asserted that an attorney friend told him Shadow Beverages was acting within SEC guidelines, but Mr. Martinez did not personally speak with the attorney.[382] The evidence of record establishes that Mr. Martinez failed to maintain adequate supervision to prove that he acted in good faith. Mr. Martinez also fails the second prong of the affirmative defense because he directly or indirectly induced the fraudulent sales through his personal involvement with those sales, namely, by discussing the investment with potential investors and/or signing the promissory notes and investment contract. Mr. Martinez has not established a defense to control person liability under A.R.S. § 44-1999(B).

F. Liability of the Marital Community

On June 3, 2016, Mr. Martinez filed a document titled Critical Information and Plea to Docket No. S-20948A-15-0422 ("Motion") which requested that Mrs. Martinez "be removed from the matter."[383] At hearing, the Administrative Law Judge noted that he did not have authority to dismiss a respondent from a case and took the Motion under advisement pending conclusion of the hearing to determine whether a recommendation to dismiss should be made to the Commission.[384] In the Motion, Mr. Martinez argued that while spouses generally have equal rights to bind community property, certain transactions will not bind the community unless both spouses join in the transaction, including "any

[378] *E. Vanguard Forex*, 206 Ariz. at 414, 79 P.3d at 101.
[379] *Id.*
[380] Tr. at 150.
[381] Tr. at 146-147; Exhs. S-72, S-87 at 82, 86-92, 94, 129.
[382] Tr. at 123, 132; Exh. M-05.
[383] Motion at 1.
[384] Tr. at 16-17.

transaction of guaranty, indemnity or suretyship."[385] Mr. Martinez cited the Arizona Court of Appeals in *Vance-Koepnick v. Koepnick* as recognizing that the purpose of A.R.S. § 25-214(C)[386] is to protect a spouse from "obligations undertaken by the other spouse without the first spouse's knowledge and consent" and that this purpose would be frustrated if the husband … were able to charge the wife's interest in the community with the debts he guaranteed."[387] Mr. Martinez contends that he was requested to sign personal guarantees for Shadow Beverages "and did so, in many cases, without [his] wife's knowledge and consent."[388] Mr. Martinez cites case law wherein Arizona courts have "held that '[t]he plain words of [§ 25–214(C)] have been construed to mean that the community is not bound by any guaranty that is not signed by both spouses, even though the guaranty was for a business that benefitted the marital community.'"[389]

Mr. Martinez also argues that his actions were taken as president of Shadow Beverages to benefit the company, not his marital community. Mr. Martinez contends the Commission should look to Arizona law regarding intentional torts "which provides that the community is not liable for one spouse's malicious acts unless it is specifically shown that the other spouse consented to the act or the community benefited from it."[390] Mr. Martinez, citing the Arizona Supreme Court in *Selby v. Savard*, argues that since a malicious tort does not generally benefit the community, the community is not liable without proof that the non-tortfeasor spouse knew of, consented to, or ratified the other spouse's wrongful act.[391] Mr. Martinez argues that there is no evidence that Mrs. Martinez "had knowledge of,

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[385] Motion at 1, citing A.R.S. § 25-214.

[386] **A.R.S. § 25-214. Management and control**
A. Each spouse has the sole management, control and disposition rights of each spouse's separate property.
B. The spouses have equal management, control and disposition rights over their community property and have equal power to bind the community.
C. Either spouse separately may acquire, manage, control or dispose of community property or bind the community, except that joinder of both spouses is required in any of the following cases:
1. Any transaction for the acquisition, disposition or encumbrance of an interest in real property other than an unpatented mining claim or a lease of less than one year.
2. Any transaction of guaranty, indemnity or suretyship.
3. To bind the community, irrespective of any person's intent with respect to that binder, after service of a petition for dissolution of marriage, legal separation or annulment if the petition results in a decree of dissolution of marriage, legal separation or annulment.

[387] *Vance-Koepnick v. Koepnick*, 197 Ariz. 162, 163, 3 P.3d 1082, 1083 (App. 1999).

[388] Motion at 1.

[389] *Rackmaster Sys. Inc. v. Maderia*, 219 Ariz. 60, 63 (App. 2008), quoting *Vance-Koepnick*, 197 Ariz. at 163.

[390] Motion at 2, citing *Shaw v. Greer*, 67 Ariz. 223, 194 P.2d 430 (1948).

[391] *Selby v. Savard*, 134 Ariz. 222, 229, 655 P.2d 342, 349 (1982).

consent to, or ratification of my conduct for Shadow [Beverages], aside from the limited guarantees she signed at my request" which he contends do not establish knowledge of, consent to, or ratification of his alleged improper actions.[392]

In its Post-Hearing Brief, the Division contends that the actions giving rise to the debt occurred while Mr. Martinez was married to Respondent Spouse and that the Martinezes have failed to rebut the presumption that a debt incurred during marriage is a community obligation. The Division concedes that a community is not bound by a guaranty not signed by both spouses. However, the Division argues it is not seeking to enforce the terms of the guaranties made by Mr. Martinez, but it is enforcing a statute prohibiting misleading omissions made in connection with the sale of securities. The Division contends that a community's protection from the guaranties of a single spouse do not protect it from other sources of liability arising from the same transaction.

In their Post-Hearing Brief, the Martinezes contend that the Division's claims are "quasi-criminal as they are asserted by a regulatory body, and are akin to an intentional tort."[393] The Martinezes cite tort cases previously mentioned in their Motion as a basis for not extending liability to the marital community. The Martinezes again argue that Mrs. Martinez had no knowledge of the wrongful acts of Mr. Martinez and the marital community did not benefit from them, therefore Mrs. Martinez and the marital community should be excluded from the Commission's order. Alternatively, the Martinezes argue that "any judgment against [Mr.] Martinez which includes his marital community must explicitly exclude any contribution to the community by [Mrs. Martinez]" or would otherwise be unequitable.[394]

The Division, in its Reply Brief, contends that the Martinezes' arguments apply the wrong standard, because "[i]f the husband acts with the object of benefiting the community … the obligations so incurred by him are community in nature, whether or not the wife approved thereof."[395] The Division argues that Mr. Martinez's goal was to make Shadow Beverages "a significant financial success" which would make his equity interest in Shadow Beverages a valuable community asset.[396]

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[392] Motion at 2.
[393] Respondents' Post-Hearing Brief at 11.
[394] Respondents' Post-Hearing Brief at 12.
[395] Division's Reply Brief at 2, quoting *Ellsworth v. Ellsworth*, 5 Ariz. App. 89, 92, 423 P.2d 364, 367 (1967).
[396] Division's Reply Brief at 2.

The Division further argues that the intentional tort cases cited by Mr. Martinez do not apply here as this is not a tort case.

The Commission has the authority to join a spouse in an action to determine the liability of the marital community.[397] With limited exceptions, all property acquired by either the husband or the wife during marriage is the community property of both husband and wife.[398] The Arizona Supreme Court has found that "the presumption of law is, in the absence of the contrary showing, that all property acquired and all business done and transacted during coverture, by either spouse, is for the community."[399]

Under A.R.S. § 25-214(B), the spouses have "equal management, control and disposition rights over their community property and have equal power to bind the community." Either spouse may contract debts and otherwise act for the benefit of the community except as prohibited under A.R.S. §

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[397] A.R.S. § 44-2031 provides, in pertinent part:
C. The commission may join the spouse in any action authorized by this chapter to determine the liability of the marital community. This subsection does not authorize the commission to join any individual who is divorced from the defendant at the time an action authorized by this chapter is filed.

[398] **A.R.S. § 25-211. Property acquired during marriage as community property; exceptions; effect of service of a petition**
A. All property acquired by either husband or wife during the marriage is the community property of the husband and wife except for property that is:
1. Acquired by gift, devise or descent.
2. Acquired after service of a petition for dissolution of marriage, legal separation or annulment if the petition results in a decree of dissolution of marriage, legal separation or annulment.
B. Notwithstanding subsection A, paragraph 2, service of a petition for dissolution of marriage, legal separation or annulment does not:
1. Alter the status of preexisting community property.
2. Change the status of community property used to acquire new property or the status of that new property as community property.
3. Alter the duties and rights of either spouse with respect to the management of community property except as prescribed pursuant to section 25-315, subsection A, paragraph 1, subdivision (a).

[399] *Johnson v. Johnson*, 131 Ariz. 38, 45, 638 P.2d 705, 712 (1981), citing *Benson v. Hunter*, 23 Ariz. 132, 134-35, 202 P. 233, 233-34 (1921).

25-214.[400] "[A] debt is incurred at the time of the actions that give rise to the debt."[401] "In an action on such a debt or obligation the spouses shall be sued jointly and the debt or obligation shall be satisfied: first, from the community property, and second, from the separate property of the spouse contracting the debt or obligation."[402] "A debt incurred by a spouse during marriage is presumed to be a community obligation; a party contesting the community nature of a debt bears the burden of overcoming that presumption by clear and convincing evidence."[403]

We first consider the argument of the Martinezes that because the debts were guaranteed, a restitution order cannot be issued against the marital community. "[W]hen the instrument is a guaranty, the community will be bound only upon the signatures of both spouses."[404] In *Chase Bank of Arizona v. Acosta*, the Arizona Court of Appeals found liability attaches to the community property of a general partner whose partnership contracted a debt, even though his spouse did not join him in signing a guaranty of the debt.[405] The Arizona Court of Appeals held that A.R.S. § 25-214(C) did not apply and community liability was imposed based upon the defendant's status as a general partner, not as a guarantor.[406]

While personal guaranties from Mr. Martinez are present on a number of the investments, the guaranties are not the instruments upon which the Commission bases an order for restitution. The

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[400] **A.R.S. § 25-215. Liability of community property and separate property for community and separate debts**
A. The separate property of a spouse shall not be liable for the separate debts or obligations of the other spouse, absent agreement of the property owner to the contrary.
B. The community property is liable for the premarital separate debts or other liabilities of a spouse, incurred after September 1, 1973 but only to the extent of the value of that spouse's contribution to the community property which would have been such spouse's separate property if single.
C. The community property is liable for a spouse's debts incurred outside of this state during the marriage which would have been community debts if incurred in this state.
D. Except as prohibited in section 25-214, either spouse may contract debts and otherwise act for the benefit of the community. In an action on such a debt or obligation the spouses shall be sued jointly and the debt or obligation shall be satisfied: first, from the community property, and second, from the separate property of the spouse contracting the debt or obligation.

[401] *Arab Monetary Fund v. Hashim*, 219 Ariz. 108, 111, 193 P.3d 802, 805 (App. 2008).

[402] A.R.S. § 25-215(D).

[403] *Hrudka v. Hrudka*, 186 Ariz. 84, 91-92, 919 P.2d 179, 186-87 (App. 1995).

[404] *Rackmaster Sys.*, 219 Ariz. at 63, 193 P.3d at 317.

[405] *Chase Bank of Arizona v. Acosta*, 179 Ariz. 563, 571, 880 P.2d 1109, 1117 (App. 1994).

[406] *Id.* The Division's Post-Hearing Brief notes opposing authority in *First Interstate Bank of Arizona, N.A. v. Tatum & Bell Ctr. Assocs.*, 170 Ariz. 99, 821 P.2d 1384 (App. 1991). We find *Tatum & Bell* distinguishable from the case before us. In *Tatum & Bell*, the Court of Appeals found no community property liability for the general partners of a partnership that guaranteed a third party's debt. *Tatum & Bell*, 170 Ariz. at 104, 821 P.2d at 1389. Here, the initial debt was not acquired by a third party, but by Mr. Martinez's own company, Shadow Beverages, and the claims against the community property are based upon instruments other than the guaranties.

instruments giving rise to a Commission order for restitution are securities, in this case promissory notes and an investment contract. Mr. Martinez's liability is based upon his violations of the Act, not his failure to perform on personal guaranties. Accordingly, the marital community of Mr. Martinez is subject to liability.

The Martinezes raise the further arguments that Mr. Martinez's actions were for the benefit of Shadow Beverages, not the marital community, and that liability should be analyzed under tort law. We find these arguments without merit. Mr. Martinez has not provided clear and convincing evidence to rebut the presumption that the debt incurred would be a community obligation. On the contrary, success for Shadow Beverages would directly have benefitted the marital community as Mr. Martinez had an equity stake in the company and he was entitled to draw a salary, which he rarely received due to the company's lack of operating capital.[407]

We further find tort law limitations on marital community liability inapplicable. As the Division argues, this is not a tort case but rather a securities enforcement proceeding under the Act. Had the legislature intended for debt arising from one spouse's violations of the Act to be excluded from community property liability, the legislature could clearly have stated such.[408] On the contrary, the legislature has expressly authorized joinder of a spouse to determine liability of the marital community for violations of the Act.[409] Even if we were inclined to consider tort law as advisory in this matter, such an analysis would not alleviate community liability. "The law is settled in Arizona that the community property of both spouses may be liable for an intentional tort committed by one of the spouses where the intent and purpose of the activity leading to the commission of the tort was to benefit the community interests."[410] The community will be found liable "if the tortious act was committed with the intent to benefit the community, regardless of whether in fact the community receives any benefit."[411] While Mr. Martinez may have ultimately obtained little financial value from his equity interest and right to a salary from Shadow Beverages, the goal was to make the company

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[407] Exhs. S-3 at SHADOW005752-SHADOW005753, S-87 at 57, 80-81, 112-115.
[408] The clearest indication of legislative intent is a statute's language. *Lowing v. Allstate Ins. Co.*, 176 Ariz. 101, 103, 859 P.2d 724, 726 (1993).
[409] § 44-2031(C).
[410] *Garrett v. Shannon*, 13 Ariz. App. 332, 333, 476 P.2d 538, 539 (1970).
[411] *Selby*, 134 Ariz. at 229, 655 P.2d at 349.

successful, which would have benefitted the marital community.[412] Accordingly, we find that the marital community of Mr. and Mrs. Martinez is subject to liability.

G. Remedies

The Division contends that the Respondents should be ordered to pay restitution and administrative penalties for violations of the Arizona Securities Act. The Respondents request that the Commission order Shadow Beverages "to pay restitution through the bankruptcy process with its current assets and receivables" and "to cease and desist operating as a company."[413]

1. Restitution

The Division asserts that Shadow Beverages raised a total of $2,140,000 from investors in violation of the Act. Shadow Beverages and Mr. Martinez have paid back approximately $552,500 to these investors. Additionally, the balance of $95,000 for the Gervasi-Van Kilsdonk note has been paid back to the investors pursuant to the Consent Order of Mr. Jones. This leaves an outstanding principal balance of $1,492,500, which the Division requests be the subject of a restitution order jointly and severally against Shadow Beverages and Mr. Martinez.

The Commission has the authority to order restitution pursuant to A.R.S. § 44-2032.[414] The evidence of record supports the Division's assertion that the principal amount of $1,492,500 remains outstanding. Accordingly, the Respondents should be liable for restitution in the amount of $1,492,500, plus interest.

2. Administrative Penalties

The Division recommends an order of administrative penalties in the amount of $75,000 against Mr. Martinez and $75,000 against Shadow Beverages. The Division fails to state its reasoning for the amounts of these recommended penalties and cites no aggravating factors. Though not successful as

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[412] Exh. S-87 at 59-60.

[413] Respondents' Post-Hearing Brief at 13.

[414] A.R.S. § 44-2032 provides, in pertinent part:

If it appears to the commission, either on complaint or otherwise, that any person has engaged in, is engaging in or is about to engage in any act, practice or transaction that constitutes a violation of this chapter, or any rule or order of the commission under this chapter, the commission, in its discretion may:

1. Issue an order directing such person to cease and desist from engaging in the act, practice or transaction, or doing any other act in furtherance of the act, practice or transaction, and to take appropriate affirmative action within a reasonable period of time, as prescribed by the commission, to correct the conditions resulting from the act, practice or transaction including, without limitation, a requirement to provide restitution as prescribed by rules of the commission. …

defenses, Mr. Martinez's contention that he was deceived by Mr. Peterson's assertions that he was properly licensed and had spoken with an attorney about compliance may be considered as mitigating factors.

Under A.R.S. § 44-2036(A), the Commission has authority to assess an administrative penalty of no more than $5,000 for each violation committed.[415] The record established that Shadow Beverages and Mr. Martinez acted as unregistered dealers or salesmen in the offer and sale of unregistered securities in seventeen investment transactions. Accordingly, we find the Respondents committed thirty-four total violations of A.R.S. §§ 44-1841 and 44-1842. We have also found a total of 21 fraud violations under A.R.S § 44-1991, based upon omissions of material fact and one misrepresentation. We have dismissed another ten alleged violations of A.R.S § 44-1991 for notes that were found not to be securities under the anti-fraud provisions of the Act. Having considered the dismissal of several violations asserted by the Division, the lack of aggravating factors and the mitigating factors asserted by Mr. Martinez, we find that a total administrative penalty of $50,000 against the Respondents would be appropriate.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Since at least June 1, 2009, Lucio George Martinez has been a resident of Arizona.[416]

2. Since at least June 1, 2009, Lisa K. Martinez has been the spouse of Lucio George Martinez.[417]

3. Shadow Beverages and Snacks, LLC, is an Arizona limited liability company organized on July 25, 2008.[418] Mr. Martinez was a co-founder of Shadow Beverages and served as president

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[415] A.R.S. § 44-2036 provides, in pertinent part:
A. A person who, in an administrative action, is found to have violated any provision of this chapter or any rule or order of the commission may be assessed an administrative penalty by the commission, after a hearing, in an amount of not to exceed five thousand dollars for each violation.

[416] Exh. S-87 at 7-8.

[417] *Id.* at 24.

[418] Exhs. S-2a, S-2b, S-2c, S-61 at ACC000048, S-62 at SHADOW005151, S-92 at 1, S-93 at 1.

from 2010.[419] As president of Shadow Beverages, Mr. Martinez handled the company's day-to-day business, managed the sales and operations teams, oversaw the company's director of administration, signed for the company's bank accounts, and signed finder's fee agreements on behalf of Shadow Beverages for bringing in capital and investments.[420]

4. Shadow Beverages has not been registered as a securities salesman or dealer with the Commission.[421]

5. Mr. Martinez has not been registered as a securities salesman or dealer with the Commission.[422]

6. Shadow Beverages built a portfolio of brands of non-carbonated beverages and meat-based snacks.[423] Shadow Beverages needed capital to run the company and produce product.[424]

7. On July 1, 2012, Shadow Beverages hired Richard Peterson as Executive Vice President of Business Development.[425] Later, Mr. Peterson would take the title Senior Vice President of Capital Acquisition.[426] When Mr. Peterson was hired, he told Mr. Martinez that he was a licensed investment advisor, however, he had no such licensure.[427] Mr. Peterson found new investors for Shadow Beverages and he had a finder's fee agreement with the company for capital he raised.[428] Mr. Peterson informed Mr. Martinez that he spoke with an attorney friend who said Shadow Beverages was acting within SEC guidelines, but Mr. Martinez did not personally speak with the attorney.[429] Mr. Martinez was Mr. Peterson's boss, but Mr. Martinez did not closely supervise Mr. Peterson's daily activities.[430]

8. From June 1, 2009 to July 18, 2014, Shadow Beverages offered and sold sixteen promissory notes and one investment contract.[431] Mr. Martinez, by himself or with others representing

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[419] Tr. at 149, 178-180; Exhs. S-2a, S-61 at ACC000048, ACC000055, S-92 at 1, 8, S-93 at 1, 8.
[420] Tr. at 149-150; Exhs. S-72, S-73, S-77 - S-80, S-84 - S-86.
[421] Exh. S-1a.
[422] Exh. S-1b.
[423] Exhs. S-61, S-62, S-92, S-93.
[424] Tr. at 47, 61; Exhs. S-64, S-65, S-68, S-69, S-88 at 188, S-89 at 304-311.
[425] Exhs. S-71, S-87 at 144-145.
[426] Exh. S-87 at 144-145.
[427] *Id.* at 53-55.
[428] Exhs. S-72, S-87 at 62.
[429] Tr. at 123, 132; Exh. M-05.
[430] Tr. at 150.
[431] Tr. at 41-42, 65-66, 86-87, 135, 151; Exhs. S-4, S-7, S-8, S-11, S-12, S-13 at ACC000324, S-18, S-19, S-22 – S-24, S-28 – S-30, S-34, S-35, S-37 – S-42, S-44 – S-47, S-49, S-50, S-53, S-54, S-56, S-57, S-88 at 223, S-89 at 266, 281, 284.

Shadow Beverages, was involved in the offer and sale of all seventeen of these transactions.[432]

9. At no relevant time were the notes or investment contract registered with the Commission.[433]

10. The seventeen investments in Shadow Beverages raised a total of $2,140,000 for the company.[434] None of the seventeen investments were timely repaid when they came due.[435] Investors were not told about the prior defaults before making their investments in thirteen of the transactions, with one investor receiving a loan agreement stating that Shadow Beverages was not in default on any indebtedness for borrowed money.[436]

11. At least four investors were not asked questions by Shadow Beverages to ascertain whether their net worth or income would qualify them as accredited investors.[437]

12. Six of the promissory notes were accompanied by a written personal guaranty on the note signed by Mr. Martinez.[438] Before making investments in five of the transactions, investors receiving personal guaranties were not told that Mr. Martinez had failed to perform on prior guaranties.[439]

13. Three of the promissory notes were accompanied with a security interest in collateral from Shadow Beverages.[440] Before making their investments in these three transactions, the investors were not told that Shadow Beverages had already given a $1,000,000 security interest to a bank in the same collateral from Shadow Beverages.[441]

14. On January 13, 2014, General Nutrition Centers was awarded a $1.4 million default

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[432] Tr. at 37-38, 49, 61-62, 137-138, 140-141, 151-152, 163-165, 168-174; Exhs. S-4, S-7, S-9, S-11, S-18, S-20, S-22, S-24, S-28, S-34, S-37, S-39, S-41, S-44, S-46, S-48, S-49, S-53, S-55, S-56, S-58, S-88 at 160, 189, 191, 198, 201, 223-224, 232-233, S-89 at 267, 269, 276, 282, 290-291.

[433] Exh. S-1a.

[434] Tr. at 41-42, 65-66, 86-87, 135, 151; Exhs. S-4, S-7, S-8, S-11, S-12, S-13 at ACC000324, S-18, S-19, S-22 – S-24, S-28 – S-30, S-34, S-35, S-37 – S-42, S-44 – S-47, S-49, S-50, S-53, S-54, S-56, S-57, S-74, S-88 at 223, S-89 at 266, 281, 284.

[435] Tr. at 51-52, 136-137, 157; Exhs. S-5, S-13 at ACC000325-ACC000326, S-18, S-24, S-74, S-88 at 192, 197-198, 224, 233, 248-249, S-89 at 267-269, 274-275, 281, 284-285, 289, 291-292, S-91.

[436] Tr. at 52, 73, 85, 88; Exhs. S-14 at SHADOW007310, S-88 at 173-174, 181, 199, 201, 234, 250, S-89 at 268, 269, 277, 282-283, 286, 290, 292.

[437] Tr. at 57-58, 76, 91-92.

[438] Exhs. S-7, S-9, S-20, S-32, S-48, S-55, S-58, S-88 at 191, 226-227.

[439] Tr. at 88, 153; Exhs. S-88 at 191, 226, S-89 at 270, 290-293.

[440] Tr. at 67-68; Exhs. S-31, S-36, S-51, S-88 at 226, 234, S-89 at 280-281.

[441] Tr. at 68, 153-154; Exhs. S-25, S-88 at 222-223, 226, 234, S-89 at 279.

judgment against Shadow Beverages.[442] After January 13, 2014, investors in six transactions were not told about the judgment against Shadow Beverages before making their investments.[443]

15. Shadow Beverages and/or Mr. Martinez eventually repaid the full principal amount for five of the investments and partially repaid the principal for another five investments, paying out a total of $552,500.[444]

16. These findings of fact are based upon the Discussion above, and those findings are also incorporated herein.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction of this matter pursuant to Article XV of the Arizona Constitution and A.R.S. § 44-1801, *et. seq.*

2. The findings contained in the Discussion above are incorporated herein.

3. Within or from Arizona, Respondents Shadow Beverages and Lucio George Martinez offered and sold securities, within the meaning of A.R.S. § 44-1801.

4. The Respondents failed to meet their burden of proof pursuant to A.R.S. § 44-2033 to establish that the securities offered and sold herein were exempt from regulation under the Act.

5. Respondents Shadow Beverages and Lucio George Martinez violated A.R.S. § 44-1841 by offering and selling securities that were neither registered nor exempt from registration.

6. Respondents Shadow Beverages and Lucio George Martinez violated A.R.S. § 44-1842 by offering and selling securities while not being registered as dealers or salesmen.

7. Respondents Shadow Beverages and Lucio George Martinez committed fraud in the offer and sale of securities, in violation of A.R.S. § 44-1991, in the manner set forth hereinabove.

8. Respondent Lucio George Martinez directly or indirectly controlled Shadow Beverages, within the meaning of A.R.S. § 44-1999, and is jointly and severally liable with Shadow Beverages for violations of A.R.S. § 44-1991.

9. Respondents Shadow Beverages' and Lucio George Martinez's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-2032.

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[442] Exhs. S-43, S-89 at 265.
[443] Tr. at 45, 63, 88; Exh. S-89 at 269-270, 277, 283, 286, 290, 292.
[444] Tr. at 51-52, 72-73, 85, 136-137; Exh. S-6, S-16, S-17, S-21, S-74, S-88 at 185, 197-198.

10. Respondents Shadow Beverages' and Lucio George Martinez's conduct is grounds for an order of restitution pursuant to A.R.S. § 44-2032 and A.A.C. R-14-4-308, and for which the marital community of Lucio George Martinez and Lisa K. Martinez should be jointly and severally liable subject to the limitations of A.R.S. § 25-215.

11. Respondents Shadow Beverages' and Lucio George Martinez's conduct is grounds to order administrative penalties pursuant to A.R.S. § 44-2036, and for which the marital community of Lucio George Martinez and Lisa K. Martinez should be jointly and severally liable subject to the limitations of A.R.S. § 25-215.

ORDER

IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Shadow Beverages and Snacks, LLC, and Lucio George Martinez, shall cease and desist from their actions, as described above, in violation of A.R.S. §§ 44-1841, 44-1842 and 44-1991.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Shadow Beverages and Snacks, LLC, Lucio George Martinez, individually, and, to the extent allowable pursuant to A.R.S. § 25-215, the marital community of Lucio George Martinez and Lisa K. Martinez, jointly and severally, shall make restitution in the amount of $1,492,500, payable to the Arizona Corporation Commission within 90 days of the effective date of this Decision. Such restitution shall be made pursuant to A.A.C. R14-4-308 subject to legal setoffs by the Respondents and confirmed by the Director of Securities.

IT IS FURTHER ORDERED that all ordered restitution payments shall be deposited into an interest-bearing account(s), if appropriate, until distributions are made.

IT IS FURTHER ORDERED that the ordered restitution shall bear interest at the rate of the lesser of 10 percent *per annum*, or at a rate *per annum* that is equal to one percent plus the prime rate as published by the Board of Governors of the Federal Reserve System of Statistical Release H.15, or any publication that may supersede it on the date that the judgment is entered.

IT IS FURTHER ORDERED that the Commission shall disburse the restitution funds on a *pro rata* basis to the investors shown on the records of the Commission. Any restitution funds that the

Commission cannot disburse because an investor refuses to accept such payment, or any restitution funds that cannot be disbursed to an investor because the investor is deceased and the Commission cannot reasonably identify and locate the deceased investor's spouse or natural children surviving at the time of distribution, shall be disbursed on a *pro rata* basis to the remaining investors shown on the records of the Commission. Any funds that the Commission determines it is unable to or cannot feasibly disburse shall be transferred to the general fund of the State of Arizona.

IT IS FURTHER ORDERED that Respondents Shadow Beverages and Snacks, LLC, Lucio George Martinez, individually, and the marital community of Lucio George Martinez and Lisa K. Martinez, jointly and severally, shall pay to the State of Arizona administrative penalties in the amount of $50,000 for Shadow Beverages and Snacks, LLC's and Mr. Martinez's multiple violations of the registration and antifraud provisions of the Securities Act, pursuant to A.R.S. §§ 44-2036 and 25-215. Said administrative penalties shall be payable by either cashier's check or money order payable to "the State of Arizona" and presented to the Arizona Corporation Commission for deposit in the general fund for the State of Arizona.

IT IS FURTHER ORDERED that the payment obligations for these administrative penalties shall be subordinate to the restitution obligations ordered herein and shall become immediately due and payable only after restitution payments have been paid in full or upon Respondents' default with respect to Respondents' restitution obligations.

IT IS FURTHER ORDERED that if Respondents fail to pay the administrative penalties ordered hereinabove, any outstanding balance plus interest, at the rate of the lesser of ten percent *per annum* or at a rate *per annum* that is equal to one percent plus the prime rate as published by the Board of Governors of the Federal Reserve System in Statistical Release H.15 or any publication that may supersede it on the date that the judgment is entered, may be deemed in default and shall be immediately due and payable, without further notice.

IT IS FURTHER ORDERED that if any of the Respondents fail to comply with this Order, any outstanding balance shall be in default and shall be immediately due and payable without notice or demand. The acceptance of any partial or late payment by the Commission is not a waiver of default by the Commission.

IT IS FURTHER ORDERED that default shall render Respondents liable to the Commission for its cost of collection and interest at the maximum legal rate.

IT IS FURTHER ORDERED that if any of the Respondents fail to comply with this Order, the Commission may bring further legal proceedings against the Respondent(s) including application to the Superior Court for an order of contempt.

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IT IS FURTHER ORDERED that pursuant to A.R.S. § 44-1974, upon application the Commission may grant a rehearing of this Order. The application must be received by the Commission at its offices within twenty (20) calendar days after entry of this Order. Unless otherwise ordered, filing an application for rehearing does not stay this Order. If the Commission does not grant a rehearing within twenty (20) calendar days after filing the application, the application is considered to be denied. No additional notice will be given of such denial.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN FORESE | COMMISSIONER DUNN

COMMISSIONER TOBIN | COMMISSIONER LITTLE | COMMISSIONER BURNS

EXCUSED
COMM. BURNS

IN WITNESS WHEREOF, I, TED VOGT, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 22nd day of June 2017.

TED VOGT
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____
MP/rt

SERVICE LIST FOR: SHADOW BEVERAGES AND SNACKS, LLC, LUCIO GEORGE MARTINEZ AND LISA K. MARTINEZ

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